Final Course

(Revised Scheme of Education and Training)

Study Material

Elective Paper 6B

Financial Services and Capital Markets

Part – A

BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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SYLLABUS

PAPER 6 B : FINANCIAL SERVICES AND CAPITAL MARKETS

(One paper – Three hours – 100 marks)

Objective:

1. To gain knowledge of financial services rendered by intermediaries and banks and their role and activities in the financial market in general and capital markets in particular;
2. To acquire the ability to apply such knowledge to address issues in practical scenarios.

Contents:

1. Global Financial Markets

- Introduction to Global Financial Market
- Role of Financial Market in Economic Development of a country
- Stakeholders in Financial Market (Domestic and Global)
- Indian Financial Market scenario

2. Impact of various Policies of Financial Markets

- Credit Policy of RBI
- Fed Policy
- Inflation Index, CPI, WPI, etc.

3. Capital Market - Primary

- New Issue Market – Domestic and Global
- Private Placement , QIP, Disinvestment
- Right Issue

4. Capital Market - Secondary

- Secondary Market
- Stock Market Operations
- Indian Debt Market

5. **Money Market**

- Basics of Money Market
- Money Market Participants
- Money Market Instruments
- Repo and Reverse Repo
- CRR, SLR
- MIBOR, LIBOR
- Government Securities Market

6. **Institutions and Intermediaries**

- Depository
- Stock and Commodity Exchanges – Indian and Global
- Intermediaries
- Institutional Investors
- FPIs
- Custodians
- Clearing Houses

7. **Commodity Market**

- What are Commodity Markets
- Role of Commodity Markets
- Commodity Market in India
- Application of Derivative in Commodities
- Global Commodities Exchanges

8. **Banking as source of Capital including NBFCs**

- Concept of Project Financing
- Working Capital Management
- Reverse Mortgage

9. **Mutual Funds**

- Meaning

- Evolution
- Types
- Performance Measures, NAV
- Mutual Fund Organisation
- Advantages and Disadvantages of Mutual Fund
- Exchange Traded Funds (ETFs)
- Real Estate Investment Trusts (ReITs)
- Infrastructure Investment Trusts (Invits)

10. Private Equity

- Meaning and Classification
  - ❖ Venture Capital
  - ❖ Buyouts
  - ❖ Special Cases
  - ❖ Hurdle rate
  - ❖ Paid in Capital
  - ❖ Term Sheet
- Cost of Investing in Private Equity
- Exit Routes
- Valuation of Private Equity Transactions
- Private Equity Funds (Distribution of returns in General Partner and Limited Partners)

11. Investment Banking

- Concept
- Functions
- Challenges
- Developments in Investment Banking
- Merchant Banking and issue management

12. Credit Rating

- Introduction
- Rating Services
- Objectives and types
- Uses
- Credit Rating Process
- Credit Rating Methodology
- Rating Revisions
- Credit Rating Agencies in India and abroad
- Limitations with case studies

13. Treasury Operations

- Raising and Deployment of Funds
- Risk Management

14. Risk Management

- Preventive Controls
- Early Signals
- Credit Risk

15. Credit Derivatives

- Credit Default Swaps
- Collateralized Debt Obligations (CDO)
- Pricing of Credit Derivative Instruments

16. Leasing

- Meaning, types, advantages and disadvantages of Leasing
- Financial evaluation of lease proposal from perspective of Lessee and Lessor
- Break Even Lease Rental (BELR) from Lessee's and Lessor's point of view
- Cross Border Leasing
- Regulatory Aspects of Leasing

17. Factoring

- Concept, Definition and Mechanism of Factoring
- Types/Forms of Factoring
- Functions of a Factor
- Benefits of Factoring
- Factors inhibiting the growth of Factoring in India
- Forfaiting
- Forfaiting vs Export Factoring
- Regulatory Aspects of Factoring

18. SEBI Guidelines

Following topic are covered in the paper of Strategic Financial Management (Paper – 2) and Corporate and Economic Laws (Paper – 4) also forms the part of the syllabus

- Securitization
- Fixed Income Securities (Valuation of Bonds/ Debentures)
- Derivatives
- Interest Rate Risk Management
- The Securities and Exchange Board of India Act, 1992
- Legislative framework on listing agreements
- The Securities Contract (Regulation) Act, 1956
- Chapter III-D of the RBI Act, 1934

BEFORE WE BEGIN …

Revised Scheme of Education and Training: Bridging the competence gap

The role of a chartered accountant is evolving continually to assume newer responsibilities in a dynamic environment. There has been a notable shift towards strategic decision making and entrepreneurial roles that add value beyond traditional accounting and auditing. The causative factors for the change include globalisation leading to increase in cross border transactions and consequent business complexities, significant developments in information and technology and financial scams underlining the need for a stringent regulatory set up. These factors necessitate an increase in the competence level of chartered accountants to bridge the gap in competence acquired and competence expected from stakeholders. Towards this end, the scheme of education and training is being continuously reviewed so that it is in sync with the requisites of the dynamic global business environment; the competence requirements are being stepped up to enable aspiring chartered accountants to acquire the requisite professional competence to take on new roles.

Introducing “Electives”: Significant feature of the Revised Scheme of Education and Training

In the Revised Scheme of Education and Training, the concept of electives is being introduced at the Final level in line with the school of thought that specialisation is the key to developing professionally competent chartered accountants. As per this school of thought, an emerging chartered accountant has to be geared up to assume new roles as consultants and advisors, necessitated on account of growing business complexity, dynamic changes in legislations and regulatory requirements and client expectations.

The seven core papers, namely, Financial Reporting, Strategic Financial Management, Advanced Auditing and Professional Ethics, Corporate and Economic Laws, Strategic Cost Management and Performance Evaluation, Direct Tax Laws and Indirect Tax Laws, represent the competence areas in respect of which an aspiring chartered accountant has to be technically well equipped, regardless of his intended future specialization or role. These subjects, in fact, provide the base to enable an aspiring chartered accountant to specialize in any professional accounting role. For instance, the core paper on direct tax laws and international taxation lays the foundation for further specialisation in the area of international taxation. Further, consequent to borderless economies, it has become imperative that subjects which transcend the borders be added in the curriculum, for instance, Global Financial Reporting Standards and International Taxation.

The six elective papers introduced in the Revised Scheme are Risk Management, Financial Services and Capital Markets, International Taxation, Economic Laws, Global Financial Reporting Standards and Multi-disciplinary case study. Students have to opt for one out of these six papers keeping in mind their desired area of specialization.

Framework and brief introduction of Chapters

The Elective Paper 6B – Financial Services and Capital Markets is a blend of theory and practical. The Study Material has been segregated into two parts i.e. Part A and Part B. Part A consists of Chapter 1 to 17 as mentioned in the syllabus and Part B consists of SEBI Regulations as depicted in detailed contents of Part B of the Study Material.

The study material is prepared by keeping in mind the current scenarios in the financial services and capital markets operating, wherever, required. Similarly, students will also get familiarized with the various concepts of capital market. In the chapter, Capital Market – Primary, some of the new concepts currently in vogue has been introduced such as Green Shoe Option, Application Supported by Blocked Amount (ASBA), Anchor Investors etc. Similarly, in the Chapter, Capital Market - Secondary, certain interesting topics such as Straight Through Processing (STP), Securities Lending and Borrowing, Circuit Breakers, Margin Trading have been lucidly explained.

Banking plays an important role in the financial market in India. Therefore, a Chapter - Banking as source of Capital including NBFCs has been added. This chapter throws light on Project Financing, Bank Loan in the form of Working Capital and term loan, financing through NBFCs, Working Capital Management and Reverse Mortgage.

Further, some chapters such as Commodity Market, Risk Management, Treasury Operations, and Credit Derivatives have been added to give a wide coverage to the subject Financial Services and Capital Markets. In these chapters some contemporary topics have been added to give a new flavor to this dynamic subject.

Moreover, some more chapters such as Private Equity, Investment Banking and Credit Rating have been added to give a further boost to the ever evolving field of Financial Services and Capital Markets.

And, last but not the least; two chapters, i.e. Leasing and Factoring are included on account of their importance in Financial Services.

Features of this study material

There are several significant characteristics of this study material which are outlined as below:

(i) It comprehensively covers the course requirements of students preparing for Financial Services and Capital Markets paper.

(ii) The chapters have been organized in such a manner that the concepts of the students are cleared in a step by step process.

(ii) It is written in a very simple and lucid manner to make the subject understandable to the students.

(iii) At the beginning of each chapter, learning outcomes have been given so that the students have some sort of idea about what he will learn after going through the chapter.

(iv) Efforts have also been made to cover new concepts in various chapters of Financial Services and Capital Market Paper e.g. Primary Market, Secondary Market, Private Equity, Commodity Market, and Credit Derivatives.

(v) While preparing the study material, it has been kept in mind that students understand the concepts covered in the study material. Accordingly, chapters have been kept concise, giving appropriate headings, sub-headings and mentioning examples at suitable places.

Strategy to approach this study material

It is desired from the students that they cover the entire syllabus and also required to visit ICAI Website for additional material in the form of Supplementary, Case lets etc. Students are also advised to update themselves with the latest changes in the financial sector. The students are therefore required to refer academic updates in 'Students Journal' published by the Board of Studies, the monthly journal 'The Chartered Accountant', and financial newspapers such as Economic Times, Mint, Business Line and Business Standard.

This Part of Study Material has to be referred in conjunction with Part B of the Study Material. Please note that while Part A may be revised, if required, Part B will be revised on yearly basis. Hence, it is essential that students should refer the applicable edition of Part B of Study Material as per the announcement being hosted at ICAI Website on time to time basis.

Although, sincere efforts have been made to keep the study material error free, it is possible that some errors might have inadvertently crept in. In this respect, students are encouraged to highlight any mistake they may notice while going through the study material by sending an e-mail at fscm-final@icai.in or write to the Director of Studies, The Institute of Chartered Accountants of India, A-29, Sector-62, Noida-201309.

Happy Reading and Best Wishes!

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DETAILED CONTENTS : PART A

CHAPTER 8 – BANKING AS SOURCE OF CAPITAL INCLUDING NBFCS

CHAPTER 9 – MUTUAL FUNDS

CHAPTER 10 – PRIVATE EQUITY

CHAPTER 11 – INVESTMENT BANKING

CHAPTER 12 – CREDIT RATING

CHAPTER 13 – TREASURY OPERATIONS

CHAPTER 1

GLOBAL FINANCIAL MARKETS

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Introduction to Global Financial Market
- Role of Financial Market in Economic Development of a country
- Stakeholders in Financial Market (Domestic and Global)
- Indian Financial Market Scenario

1. INTRODUCTION TO GLOBAL FINANCIAL MARKETS

Source: Google to https://slideplayer.com/slide/5917511/

Financial markets are a marketplace that provides an avenue for the sale and purchase of financial assets such as equity stocks, bonds, foreign exchange, commodities, derivatives, etc.

1.1 Major types of financial markets

1.1.1 Stock market

Stock market is the market for trading in equity stocks of companies. Typically, dividend yield in stocks is on the lower side, as dividend is declared as a percentage of the face value of the stock whereas the price in the secondary market runs up. That is, as a percentage of market price, the return to the investor is on the lower side. Gains come from capital price appreciation in the secondary market. This market is volatile, as the price in secondary market reflects expectations going forward, on the economy and corporate earnings.

1.1.2 Bond market

The bond market offers an avenue for companies and the government to raise money to finance a project or a deficit, with a defined repayment timeline. In a bond market, investors buy bonds from a company, and the company returns the amount of the bonds on the stipulated date, along with the coupon or interest payment as agreed.

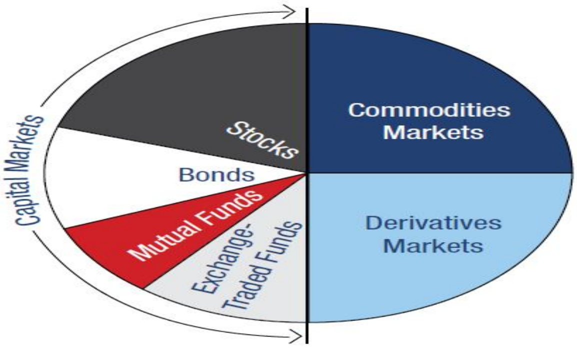
1.1.3 Commodities market

The commodities market is where traders and investors buy and sell natural resources or commodities such as corn, oil, pulses, meat, gold, etc. In the commodities futures market, prices of items to be delivered at a given future date are decided in the present.

1.1.4 Derivatives market

This market deals in derivatives or contracts whose value is based on the market value of the asset being traded, called the underlying. The commodities futures mentioned above are an example of a derivative. Currency and equity derivatives are popular. Further, according to one study, India and China top the world's commodity market.

Source: https://www.accountingfoundation.org/jsp/Foundation/Page/FAFSectionPage&cid=1351027541272



1.2 Importance of Financial Markets

There are many social benefits that financial markets facilitate, including:

- They provide individuals, companies, governments and quasi-government organizations with access to capital;
- People with surplus funds for investment get channels for investment and are assured of fair treatment as there is a regulator. If it is an unorganized place and not a proper market, transactions may go in the wrong direction;
- Financial markets create jobs as there are many people involved in direct and indirect activities.

1.3 Size of the Global Financial Market

The biggest markets are that of derivatives, though conventionally we tend to think of Equity or Bond markets as large. Globally, derivatives markets are much more developed.

Source: Google to https://topforeignstocks.com/2011/08/23/how-big-is-the-global-financial-industry/

The chart above shows that the notional amount of financial derivatives outstanding is much higher than the traded volume of stocks and bonds.

2. ROLE OF FINANCIAL MARKET IN ECONOMIC DEVELOPMENT OF A COUNTRY

For economic development, a country needs capital, and the capital markets discussed above e.g. equities, bonds, etc. channelize those resources. Through the financial market or capital market system, funds flow from those who have surplus funds to those who have a shortage of funds, either by direct, market-based financing or by indirect, bank-based finance. Without a properly functioning stock market, price discovery of corporations would not happen and resource mobilization through IPOs would be hampered.

2.1 Functions of Financial Markets

The role of financial markets in the success and strength of an economy is immense. Some important functions of financial markets are:

✓ **Puts savings into more productive use**

Money in savings account should be put to productive use. Financial institutions like banks loan it out to individuals and companies that need it for say home loan, study loan, business purposes, big projects, etc. savings as such does not have any meaning; it is investment that puts it to productive use.

✓ **Determines the price of securities**

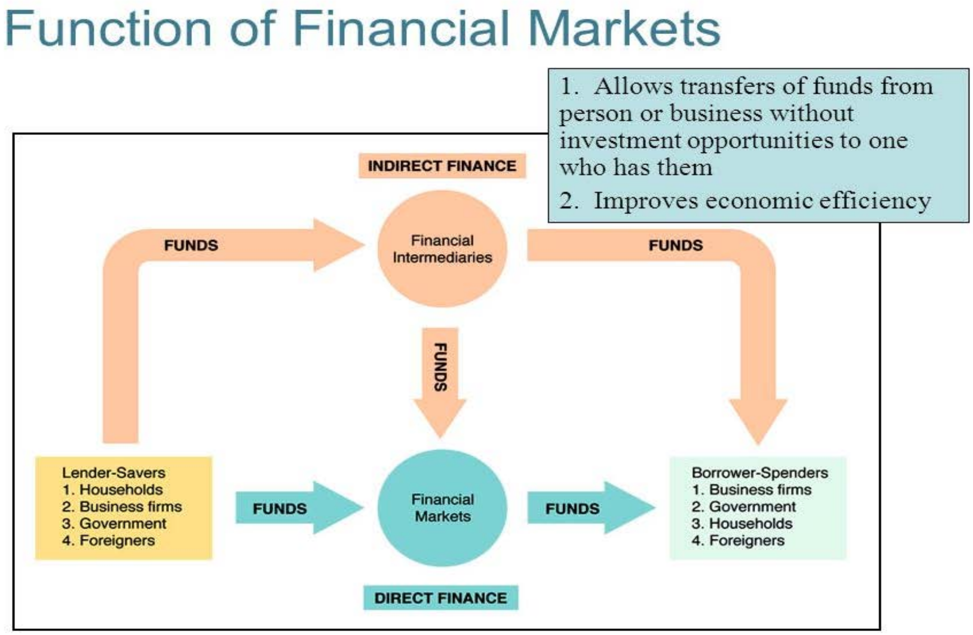
Once a security is listed, buyers and sellers trade in it, and the traded price reflects the prospects of the company whose instruments are being traded. This is called price discovery. Prices of securities are determined in financial markets, which is an important function.

✓ **Makes financial assets liquid**

Buyers and sellers can decide to trade their securities anytime, provided there is a counterpart. Financial markets provide this avenue, and that creates liquidity in the security. This imparts liquidity to investors and incentivizes them to invest.

✓ **Lowers the cost of transactions**

In financial markets, various types of information regarding securities can be acquired without the need to spend. The Exchanges and market participant associations disseminate relevant information. The companies also can disseminate information, but they would put forth only what they want to propagate, not what is useful for investors.



Source: Google to https://slideplayer.com/slide/5737595/

Financial markets facilitate the flow of savings and investment in the economy for generation of capital and the production of goods and services.

2.2 The linkages in financial flows

As we see in the diagram above, households save, and invest through financial institutions. Apart from households, the corporate or business sectors also may have surplus from time to time, which is invested through financial institutions. For economic development of a country, the business sector and the government needs resources, which is mobilized by the financial institutions and markets? The government may need to borrow from the market, which is facilitated by financial markets. Resources may be mobilized from abroad as well, depending on the relative growth potential of the two economies.

The resources i.e. funds are deployed in the real economy by the government and private sector business firms, for creation of capacities and for running the wheel i.e. necessary revenue expenditure. The production of business firms is consumed by the household sector. Government taxes are collected from the business sector.   Economic development happens through increasing the size of the pie shown above, which is denoted by the GDP growth rate, by generating efficiencies in the production process and increasing the speed of the cycle. While generating efficiencies is the job of the participants in the production process, the resource that moves the wheel is finance.

Financial markets provide this resource. It has to be done at an optimum cost; it should be low enough to incentivize producers to raise resources and high enough for households to save. The more efficient financial markets are, the more efficient is this process of price discovery.

2.3 Contribution of market to economy

The state of development of the financial markets reflects the state of development of the economy, and vice versa. It is a relationship of symbiosis, as the market and the economy feed from each other.

According to Baily and Elliott, there are three major functions of the financial system:

Credit Provision - Credit supports economic activity. Governments can invest in infrastructure projects by reducing the cycles of tax revenues and correcting spends, businesses can invest more than the cash they have and individuals can purchase homes and other utilities without having to save the entire amount in advance. Banks and other financial service providers give this credit facility to all stakeholders.

Liquidity provision - Banks and other financial providers protect businesses and individuals against sudden cash needs. Banks provide the facility of demand deposits which the business or individual can withdraw at any time. Similarly, they provide credit and overdraft facility to businesses. Moreover, banks and financial institutions offer to buy or sell securities as per need and often in large volumes to fulfill sudden cash requirements of the stakeholders.

Risk management services - Finance provides risk management from the risks of financial markets and commodity prices by pooling risks. Derivative transactions enable banks to provide this risk management. These services are extremely valuable even though they receive a lot of flak due to excesses during financial crisis.

According to Global Financial Development Report of World Bank of 2014, “Fundamentally, financial sector development concerns overcoming “costs” incurred in the financial system. This process of reducing costs of acquiring information, enforcing contracts, and executing transactions results in the emergence of financial contracts, intermediaries, and markets. Different types and combinations of information, transaction, and enforcement costs in conjunction with different regulatory, legal and tax systems have motivated distinct forms of contracts, intermediaries and markets across countries in different times.”

According to Levine, “The five key functions of a financial system in a country are: (i) information about possible investments and capital allocation; (ii) monitoring investments and the exercise of corporate governance after providing financing; (iii) facilitation of the trading, diversification, and management of risk; (iv) mobilization and pooling of savings; and (v) promoting the exchange of goods and services.”

3. STAKEHOLDERS IN FINANCIAL MARKET (DOMESTIC AND GLOBAL)

Various stakeholders in the financial market can be categorized into following four segments:

(i) **Primary stakeholders in financial market**

- Shareholders
- Lenders
- Companies
- Mutual fund Organizations/holders/fund managers

(ii) **Service providers in financial market**

- Merchant Bankers
- Brokers
- Underwriters
- Depositories
- Custodians

(iii) **Regulators in financial market**

- Securities and Exchange Board of India (SEBI)
- Reserve Bank of India
- Insurance Regulatory and Development Authority of India (IRDAI)
- Pension Fund Regulatory and Development Authority (PFRDA)

(iv) **Administrators to facilitate the financial market**

- Association of Mutual funds of India (AMFI)
- Foreign Exchange Dealers Association of India (FEDAI)
- Fixed Income Money Market and Derivative Association of India (FIMMDA)
- Association of Investment Bankers of India (AIBI)

(i) Primary stakeholders in financial market

(a) Shareholders: In simple language, shareholders are the owners of a company. So, a shareholder is any person such as an individual, company or other institution who hold at least one share out of company's total shares. As shareholders are owners of the company they get benefit when the share prices increase. In the same way, the shareholders lose out when the company's shares plummet.

The shareholders participate in the financial market (secondary market) by buying and selling shares. Their actions depend upon which way the market is behaving. If the market price is low, they tend to buy more shares. On the other hand, if the market price of shares is high, they will sell more shares to book profit. Thus, they provide the much needed liquidity in the stock market.

(b) **Lenders:** A lender in relation to a financial market is either a company or any other form of corporation that issues bonds or debentures to make its end meet. Funds are available to another with the expectation that the funds will be repaid, in addition to any interest and/or fees, either in increments or as a lump sum. They also provide the much needed liquidity in the financial market by facilitating the flow of funds from deficit spending to surplus spending sectors.

(c) **Corporates:** Corporates raise money either through the share market route or through the bond market route. Raising money by issuing shares to the public generally helps the companies to amass huge amount of capital. It keeps the financial market ticking by enabling mobilization and allocation of saving from the people, be it, individual investors, companies and institutional investors whether foreign or domestic.

However, raising of equity share capital has its repercussions. Cost of equity share capital is costly. Moreover, companies have to meet a lot of regulatory compliances at the time of initial public offerings which takes a lot of time, energy and money. But, if the company managed to keep its share prices on the higher side, it will easily get more funds in the future whether through equity or debt. If the company opting to raise funds through the debt route, it has certain advantages and disadvantages. The benefits are lower cost of capital in comparison to equity. The debt route also tends to increase the earning per share (EPS) of the company which consequently leads to escalation of share prices of the company. And, the demerit is that a debt has to be repaid alongwith interest. So, too much of debt may lead an organization to financial/default risks and may land it in financial distress.

(d) **Mutual fund Organizations:** A mutual fund is a financial institution or intermediary that pools the savings of investors for collective investment in a diversified portfolio of securities. A fund is 'mutual' as all of its returns, minus its expenses, are shared by fund's investors. A mutual fund serves as a link between the investor and the securities market by mobilizing savings from the investor and investing them in the securities market to generate returns.

(ii) Service providers in financial market

(a) **Merchant Bankers:** As per the Securities and Exchange Board of India (Merchant Banker) Regulations, 1992, merchant banker means any person who is engaged in the business of issue management, either by making arrangements regarding selling, buying, or subscribing to securities, or acting as a manager, consultant, or advisor, or rendering corporate-advisory services in relation to such issue management. It is mandatory to appoint a merchant banker in case of a public issue. The functions of merchant banker includes – submitting offer documents to SEBI, due diligence i.e. certifying that all the disclosures made in the draft prospectus or letter of offer are true and fair and will enable the investors to make an informed decision etc.

Globally, merchant banker plays more or less the same role as discussed above. Some of the top Merchant Bankers in USA are Merrill lynch, Citigroup, Goldman Sachs, J.P. Morgan and Morgan Stanley. They provide services to top companies in the world. For example, Morgan Stanley has been responsible for hundreds of technology financing and M&A transactions aggregating over $500 billion in value. Further, Goldman Sachs has served all the big names in tech, including Microsoft, Apple, Facebook, Twitter, Ebay and Alibaba.

(b) Brokers: Stock Brokers are individuals who participate in the stock market on behalf of clients. They buy and sell shares on behalf of the clients on their instructions. In order to actively participate in the capital market, they should be SEBI registered. So, they facilitate trading in the stock market (secondary market) by undertaking buy and sell transactions on behalf of the client.

In USA, most "brokers" must be registered with the Securities Exchange Commission (SEC) and join a "self-regulatory organization," or SRO. Globally, margin financing is popular, in which, many large broking houses provide financing facilities to clients who borrow money to invest in stocks. Therefore, Stock exchanges monitor the extent to which brokers are lending in line with their net worth.

(c) Underwriters: Underwriters are those persons who assume the risk of others. In capital market, in case of new issues, they assume risk by guaranteeing that in case the shares are not subscribed fully by the public, the unsubscribed portion will be subscribed by the underwriter itself. They do it by charging a small fee.

So, how do the underwriters make profit? They buy the shares of the company before they are actually listed on a stock exchange. The underwriters make their profit on the difference in price between what they paid before the IPO and when the shares are actually offered to the public.

(d) Depositories: Depository is an institution which maintains investors account in electronic form. One of the main functions of the Depository is to transfer the ownership of shares from one investor to another whenever the trading of shares takes place. It helps in reducing the paper work involved in trade, expedites the transfer and reduces the risk associated with physical shares such as damage, theft, and subsequent misuse of the certificates or fake securities.

There are two types of depositories in India which are known as NSDL (National Securities Depository Limited) and CSDL (Central Depository Services (India) Limited). They interface with the investors through their agents called Depository participants (DPs). DPs could be the banks (private, public and foreign), financial institutions or SEBI registered trading members.

Globally, depositories provide the same set of services as has been rendered by CDSL and NSDL.

(e) Custodians: Custodians provide custodial services for safe keeping of securities. Besides safe keeping, they provide other services for a fee (generally 1% of the total volume of transactions) such as physical transfer of share certificates and a trustee of the same but also provides ancillary services such as physical transfer of share certificates, collecting dividends and interest warrants and conforming to transfer regulations. Besides that, it also updates client status on their investment status. Even though securities are in the custody of depositories, the custodians act as a complementary to them by providing various services as mentioned above. In India, The Stock Holding Corporation of India (SHCIL) and the SBI Share Holding Corporation are the leading custodians.

After liberalization in 1991, **foreign institutional investors (FIIs)** were allowed to invest in the Indian Capital Market. Most of the FII business in India is routed through foreign custodians. According to the US laws, no US fund is allowed to use a custodian that does not have a capital adequacy of USD 200 million. No Indian custodian meets this requirement. Therefore, only foreign banks operate as custodians for US based FIIs, pension funds, and corporates. Hong Kong Bank, Deutsche Bank, Citi Bank, and Standard Chartered Bank are some leading foreign banks which operate as custodians.

(iii) Regulators in financial market

(a) Securities and Exchange Board of India (SEBI): SEBI was born in 1992. The basic objective was to protect the interest of investors in securities and promotes the development of securities market. The important objectives of SEBI are:

i) Protect the interest of investors in securities.

ii) Promotes the development of securities market.

iii) Regulating the securities market.

Outside India: Securities Exchange Commission (SEC) in USA performs more or less the same functions as given to SEBI. But the stark difference is the amount of penalty. SEC can impose an unlimited amount of fine which SEBI cannot. That is the reason SEC has more teeth in comparison to SEBI and acts as an effective deterrent against malpractices in the stock market.

(b) Reserve Bank of India: The Reserve Bank of India was established in 1935 with the provision of Reserve Bank of India Act, 1934. Though privately owned initially, in 1949 it was nationalized and since then fully owned by Government of India (GoI). The preamble of the Reserve Bank of India describes its main functions as to regulate the issue of Bank

Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.

Outside India: Federal Reserve (Fed) in the USA's policies is primarily driven by growth and employment figures, at the expense of inflation. On the other hand, we have the RBI, whose policies are primarily driven by inflation, at the expense of growth. So which approach is better depends upon the situation of the economy. In the USA and European Union, where rate of interest is very low encourages the industry to borrow at cheaper cost and contributes towards economic development and growth. However, in India, the aim of RBI is to keep the rate of interest high to discourage the industry to borrow large amount of money and consequently to contain inflation.

(c) Insurance Regulatory and Development Authority of India (IRDAI): IRDA Act was passed in 1999. The main aim of the Insurance Regulatory and Development Authority of India is to protect the interest of holders of Insurance policies to regulate, promote and ensure orderly growth of Insurance industry & for matters connected therewith or incidental thereto. Under this Act, Controller of Insurance under Insurance Act,1938 was replaced by newly established authority called Insurance Regulatory and Development Authority (IRDA).

Outside India: In USA, insurance is almost regulated by the individual state governments. In Canada, Office of the Superintendent of Financial Institutions Canada (OSFI)sets the minimum regulatory requirements and expectations to support policyholder and creditor protection, giving due regard to the need to allow institutions to compete effectively. As healthy companies are in the best position to protect policyholders and creditors, OSFI is aware of the impact of its requirements and expectations on competition domestically and internationally.

Insurance regulators in other jurisdictions pursue similar goals but with different legislative and policy tools and with different economic experiences and conditions. OSFI will consider the pace, scope and impact of reforms when renewing the regulatory framework, to ensure that we are able to incorporate best practices, and limit – to the extent practical – unintended consequences and an uneven playing field.

(Source: Office of the Superintendent of Financial institutions, Canada)

(d) Pension Fund Regulatory and Development Authority (PFRDA): To be a model Regulator for promotion and development of an organized pension system to serve the old age income needs of people on a sustainable basis. Pension systems throughout the world have been under close scrutiny over the last couple of decades. Numerous reforms have been carried out to tackle the sustainability and adequacy of pension arrangements in the face of the rising global demographic challenge.

Outside India: The main law which governs the establishment, maintenance, and termination of pension plans in the United States is the Employee Retirement Income Security Act (ERISA).

Prudential supervision of Australian pension funds started in 1993.The objective of the regulation regarding superannuation aimed at reducing the riskiness of superannuation investments, dealing with retirement incomes policy, equal treatment of members and various other matters.

(iv) <u>Administrative authorities to facilitate the financial market</u>

(a) Association of Mutual funds of India (AMFI): The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

AMFI, the association of SEBI registered mutual funds in India of all the registered Asset Management Companies, was incorporated on August 22, 1995, as a non-profit organization. As of now, all the 42 Asset Management Companies that are registered with SEBI are its members.

The Mutual Fund Dealers Association of Canada (MFDA) is the national self-regulatory organization (SRO) that oversees mutual fund dealers in Canada.

(b) Foreign Exchange Dealers Association of India (FEDAI): Foreign Exchange Dealers Association of India (FEDAI) was set up in 1958 as an Association of banks dealing in foreign exchange in India (typically called Authorised Dealers - ADs) as a self-regulatory body and is incorporated under Section 25 of The Companies Act, 1956. It's major activities include framing of rules governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.

Internationally, forex dealer provides online trading services to allow individuals to speculate on rapidly changing foreign exchange rates. Forex Dealer Members (FDMs) are regulated in the United States by the Commodity Futures Trading Commission (CFTC) and National Futures Association (NFA), as well as by national and local regulatory bodies where they conduct business.

(c) Fixed Income Money Market and Derivative Association of India (FIMMDA)

The Fixed Income Money Market and Derivatives Association of India (FIMMDA), an association of Scheduled Commercial Banks, Public Financial Institutions, Primary Dealers and Insurance Companies was incorporated as a Company under section 25 of the Companies Act, 1956 on June 3rd, 1998. FIMMDA is a voluntary market body for the bond, money and derivatives markets.

FIMMDA has members representing all major institutional segments of the market. The membership includes Nationalized Banks such as State Bank of India, its associate banks and other nationalized banks; Private sector banks such as ICICI Bank, HDFC Bank, IDBI Bank; Foreign Banks such as Bank of America, ABN Amro, Citibank, Financial institutions such as IDFC, EXIM Bank, NABARD, Insurance Companies like Life Insurance Corporation of India (LIC), ICICI Prudential Life Insurance Company, Birla Sun Life Insurance Company and all Primary Dealers.

The International Swaps and Derivatives Association (ISDA) is a trade organization of participants in the market for over-the-counter derivatives. It's headquarter is in New York City, and has created a standardized contract (the *ISDA Master Agreement*) to enter into derivatives transactions.

(d) Association of Investment Bankers of India (AIBI)

In the early 1990s, the merchant banking industry in India witnessed a phenomenal growth with over 1500 merchant bankers registered with SEBI. In order to ensure the wellbeing of the industry and for promoting healthy business practices, it became necessary to set up a Self-Regulatory Organization within the industry. This led to the birth of the Association of Investment Bankers of India (AIBI). AIBI was promoted to exercise overall supervision over its members in the matters of compliance with statutory rules and regulations pertaining to merchant banking and other activities. AIBI was granted recognition by SEBI to set up professional standards, for providing efficient services and to establish standard practices in merchant banking and financial services. AIBI, in consultation with SEBI, is working towards improving the compliance of statutory requirement in a systematic manner.

AIBI's primary objective is to ensure that its members render services to all its constituents within an agreed framework of ethical principles and practices. It also works as a trade body promoting the interests of the industry and of its members. *(Source www.aibi.org.in)*

Internationally, International Association of Investment Bankers (IAIB) since its inception in 1994 has leveraged its collective expertise, best practice knowledge, industry insights, and global reach to assist clients in executing mergers, acquisitions, divestitures, and strategic partnerships.

Its membership is composed of established boutique investment banks from around the world whose primary focus is advising middle market and emerging growth companies. A highly collaborative group, we hold monthly conference calls and gather twice each year to review creative transaction structures and current market dynamics, as well as to share perspectives on important industry issues. Through these efforts, they are able to offer their clients a truly differentiated advisory service that leverages the significant transaction experience and domain expertise of their member firms.

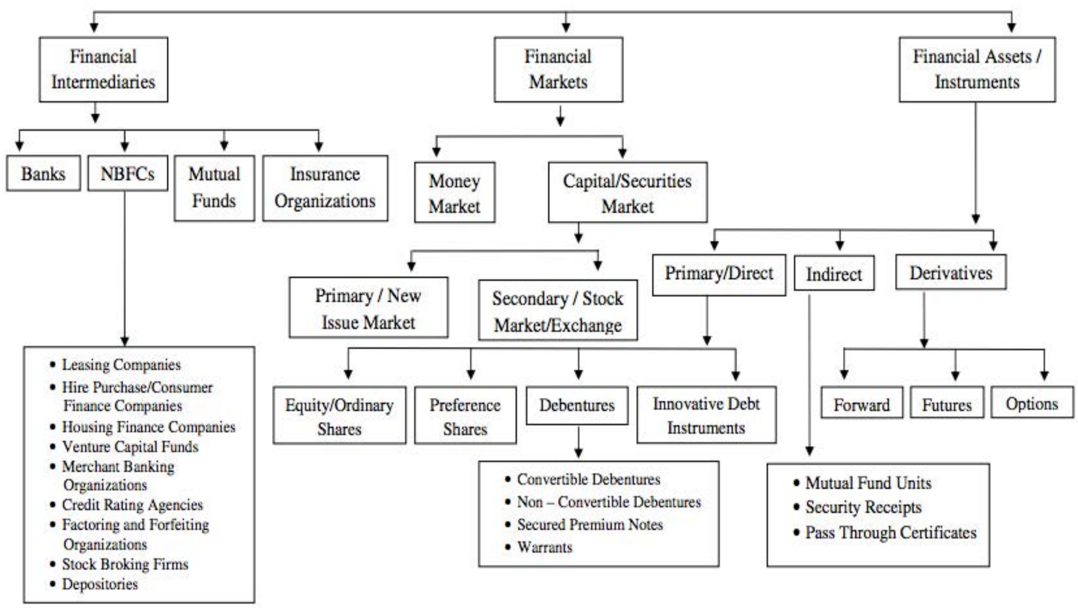
The International Association of Investment Bankers (IAIB) is an affiliation of investment banking firms from Europe, North America, Australia and Asia, working together to broaden their reach and leverage their expertise within the global marketplace.

Since 1994, the IAIB member firms have utilized this network to offer their clients worldwide access to providers of capital, advisory services and acquirers and sellers of businesses. With this capability, member firms are able to provide substantial added value to their clients beyond that typically offered by purely domestic advisors. *(Source www.iaib.org)*

4. INDIAN FINANCIAL MARKET SCENARIO

The Indian economy is a developing one and so is the Indian financial market ecosystem. The market is well regulated by SEBI, along with other regulators. The pace of development, in terms of systems and enablers, has been quite fast. Though we are yet to catch up with developed markets like USA on many parameters, it is because we are still a developing economy.

Let us look at the components of the Indian financial market:



Source: Google to http://practicemock.com/blog/lic-aao/insurance-financial-market-awareness-indian-financial-system/

4.1 Money Market Instruments

The money market is the market for financial assets that are close substitutes for money. It is the market for instruments ranging from one day deployment e.g. call money market to a few months, but upto or less than one year.

4.1.1 Treasury Bills

Treasury Bills (T-Bills) are short term instruments issued by the Central Government with maturities in less than one year. Their purpose remains the same as Dated Securities (i.e. regular Government Securities), but they are intended more to meeting the short term funding needs of the Central Government. Currently, the Central Government issues T Bills of 91-day, 182-day and

364-day maturity. Since T Bills have a maturity of less than one year, they are considered to be a money market instrument.

4.1.2 Cash Management Bills

These are a short term instrument issued by the Government of India and meant to specifically meet temporary cash flow mismatches of the Government. These instruments have a maturity of less than 91 days. Further, they are issued at a discount to par value (in the nature of zero coupon securities). CMBs have similar characteristics as Treasury Bills.

4.1.3 Call Money, Notice Money and Term Money

These are the terms used for short term borrowing and lending operations between Banks and sometimes with and between Primary Dealers. The difference between the three is in their tenure of lending. Call money is for overnight deployment i.e. one day, notice money is two to fourteen days and term money is for a tenure fifteen days and longer.

4.1.4 Certificate of Deposits (CDs)

CDs are issued by banks for short-term funding needs. Usually, banks issue CDs when credit pick-up is higher than bank deposit growth. CDs save on operational costs of the Bank as these take place in bulk.

4.1.5 Commercial Papers (CPs)

CPs are issued by corporates (mostly NBFCs), primary dealers and all-India financial institutions (other than Banks), as a source of short term finance. In a way CDs and CPs are similar, difference being CDs are issued by Banks and CPs are issued by corporates.

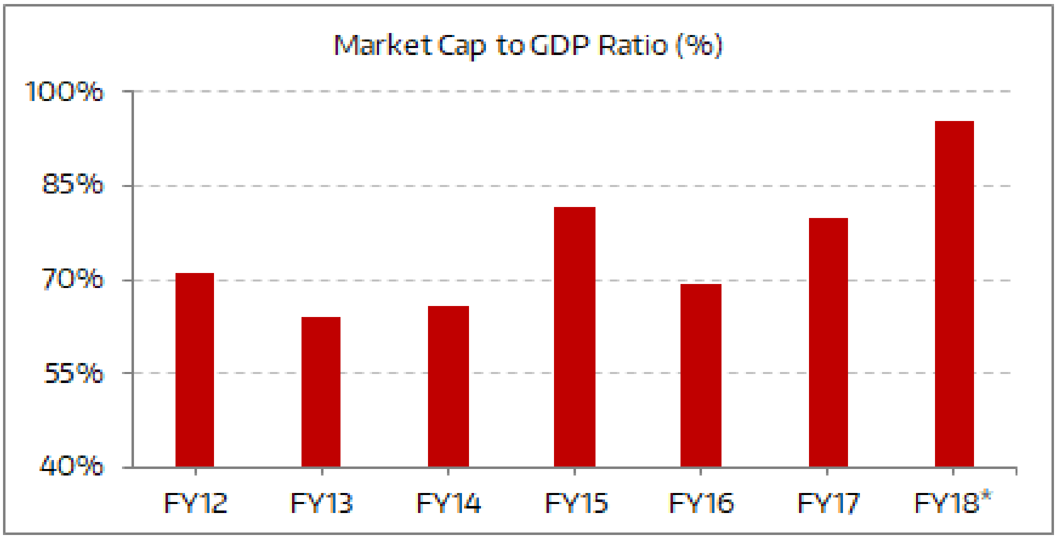
4.2 Capital Market

The capital market provides the support to corporates for raising resources. The Securities and Exchange Board of India (SEBI), along with the Reserve Bank of India are the regulatory authorities for Indian securities market, to protect investors and improve the microstructure of capital markets in India.

There are two components of capital market, primary and secondary. In primary market, companies, governments or public sector institutions can raise funds through bond issues. In primary market, the investor directly buys shares / bonds of a company. In secondary markets, the shares / bonds are bought and sold by the customers. On the platforms provided by Exchanges like NSE or BSE, investors buy and sell instruments like stocks and bonds through brokers / sub-brokers.

4.2.1 Indian Capital Market scenario (Equity Market)

The market capitalization to Gross Domestic Product (GDP) ratio shows to what extent the market is assigning a value to the listed corporates against the GDP of the economy. The perspective is the current value against the historical average. The stock market capitalization-to-GDP ratio is also known as the Buffett Indicator, after legendary investor Warren Buffett, who popularized its use. This measure the total value of all listed shares divided by the GDP.

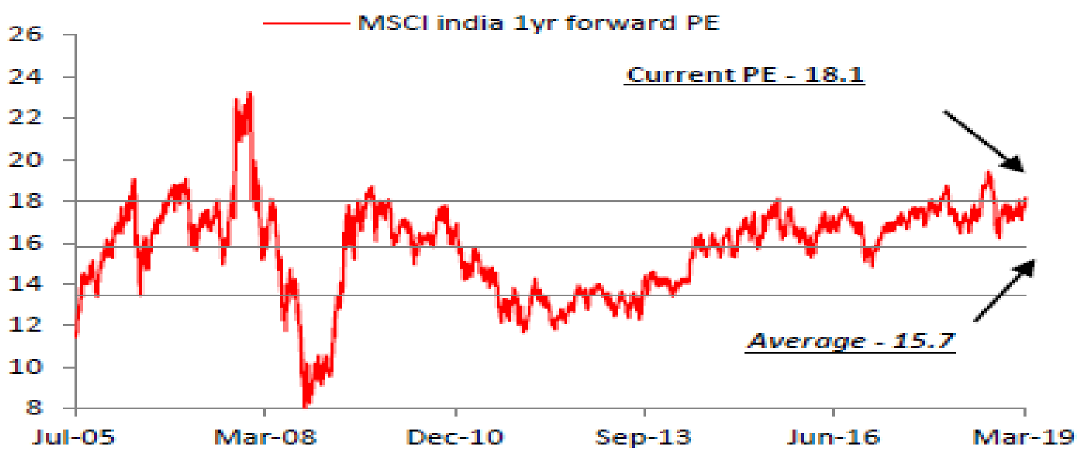


www.equitymaster.com

Source: RBI, BSE, Business Standard
*FY18-as on 26 Dec 2017

The chart above shows that investments in, and discounting of future earnings growth of Indian companies has been moving up over the last six years, represented by the increase in the ratio of market capitalization to GDP.

However, earnings growth of companies have not kept pace with the increase in valuations given by the market, as indicated in the chart above. If EPS does not grow as much and price goes up, the market valuation, as represented by P/E ratio, moves to the higher side.



Source: PhillipCapital India Research

The P/E ratio, calculated on the basis of forward or expected EPS, has moved to the higher side.

4.2.2 Historical Returns from Equity

Returns from equity market have been volatile. The following chart shows returns from Sensex since inception on a rolling basis. Annual rolling means returns of every one year calculated every year, three-year rolling return means returns over past three years, calculated every year, and so on.

Year End (1)	Sensex (2)	Rolling 1 YR Growth (3)	Rolling 3 YR Growth (4)	Rolling 5 YR Growth (5)	Rolling 10 YR Growth (6)	Rolling 15 YR Growth (7)	Rolling 20 YR Growth (8)
Mar-79	100						
Mar-80	129	29%					
Mar-81	173	35%					
Mar-82	218	26%	30%				
Mar-83	212	-3%	18%				
Mar-84	245	16%	12%	20%			
Mar-85	354	44%	18%	22%			
Mar-86	574	62%	39%	27%			
Mar-87	510	-11%	28%	19%			
Mar-88	398	-22%	4%	13%			
Mar-89	714	79%	8%	24%	22%		
Mar-90	781	9%	15%	17%	20%		
Mar-91	1168	50%	43%	15%	21%		
Mar-92	4285	267%	82%	53%	35%		
Mar-93	2281	-47%	43%	42%	27%		
Mar-94	3779	66%	48%	40%	31%	27%	
Mar-95	3261	-14%	-9%	33%	25%	24%	
Mar-96	3367	3%	14%	24%	19%	22%	
Mar-97	3361	0%	-4%	-5%	21%	20%	
Mar-98	3893	16%	6%	11%	26%	21%	
Mar-99	3740	-4%	4%	0%	18%	20%	20%
Mar-00	5001	34%	14%	9%	20%	19%	20%
Mar-01	3604	-28%	-3%	1%	12%	13%	16%
Mar-02	3469	-4%	-2%	1%	-2%	14%	15%
Mar-03	3049	-12%	15%	-5%	3%	15%	14%
Mar-04	5591	83%	16%	8%	4%	15%	17%
Mar-05	6493	16%	23%	5%	7%	15%	16%
Mar-06	11280	74%	55%	26%	13%	16%	16%

Mar-07	13072	16%	33%	30%	15%	8%	18%
Mar-08	15644	20%	34%	39%	15%	14%	20%
Mar-09	9709	-38%	-5%	12%	10%	6%	14%
Mar-10	17528	81%	10%	22%	13%	12%	17%
Mar-11	19445	11%	8%	12%	18%	12%	15%
Mar-12	17404	-10%	21%	6%	18%	12%	7%
Mar-13	18836	8%	2%	4%	20%	11%	11%
Mar-14	22386	19%	5%	18%	15%	13%	9%
Mar-15	27957	25%	17%	10%	16%	12%	11%
Mar-16	25342	-9%	10%	5%	8%	14%	11%
Mar-17	29621	17%	10%	11%	9%	15%	11%
Probability of Gain		25/38	30/36	31/34	28/29	24/24	19/19

Source: HDFC Mutual Fund

How to read it?

Return of 29% from March 1979 to March 1980 means over a holding period of one year. Then it goes on like this every year. Return of 30% from March 1979 to March 1982 means over a holding period of 3 years, annualized. Similarly, the same pattern will be followed for other 3-year holding periods.

Conclusion:

On a one-year holding period basis, returns were positive in 25 out of 38 years, hence the probability of positive return is 25/38. Over 10-year holding periods, it is positive in 28 out of 29 years, hence over a long holding period probability of positive return is 28/29. Over 15 and 20 year holding periods, it is always positive.

4.2.3 Bond Market

The Government and corporates issue bonds / debentures for raising resources. The market capitalization concept is not used in the bond market as the market price is not much different from the face value of instruments. To gauge the size of the market, we will look at the outstanding quantum of securities.

	Amount outstanding as on 31 Dec 2015 (Rs Cr)	% of total Dec '15	Amount outstanding as on (Rs Cr)
G Secs	45,19,205	51	**54,77,720** (28 Jan '19)
SDLs	14,51,236	16	**23,66,390** (Sep '18)
T Bills	4,25,648	5	**4,96,590** (25 Jan '19)
Total Sovereign	63,96,089	72	Not added the numbers above as the dates are different
Corporate Bonds	19,11,226	22	**29,48,165** (31 Dec '18)
CPs	3,08,509	4	**5,54,020** (15 Jan '19)
CDs	2,06,559	2	**1,82,140** (4 Jan '19)
Total Corporate	24,26,294	28	Not added the numbers above as the dates are different
Total	88,22,383	100	

Source: RBI, SEBI

As we observe from the chart above, the outstanding quantum of Government Securities, both Centre and States, have been going up steadily. This is in line with the GDP growth of the country and increase in size of Government budgets. The Central Government is the major issuer of securities in the bond market.

Corporate bonds and Commercial Papers also have been increasing steadily, in line with the growth of the corporate sector. This is another means of raising resources for them, apart from Bank loans.

Money market instruments like Treasury Bills and Certificates of Deposit have not increased much as these are means of short term funding. CPs have increased in quantum as the major issuers are NBFCs; NBFCs require money as that is their input and output.

4.2.4 Subscribers to Government Securities

Table 4.4: Ownership Pattern of Government of India Dated Securities

(Per Cent of Outstanding Dated Securities)

Category	2016			2017				2018
	Sep.	Dec.	March	Jun	Sep	Dec	March	June
1. Commercial Banks	40	40.9	40.5	39.7	40.4	41.4	42.7	41.8
2. Non-Bank PDs	0.1	0.3	0.2	0.3	0.3	0.3	0.3	0.3
3. Insurance Companies	22.7	22.5	22.9	23.1	23.5	23.6	23.5	24.2
4. Mutual Funds	2.1	2	1.5	1.4	1.9	1.3	1	1.1
5. Co-operative Banks	2.5	2.6	2.7	2.7	2.6	2.7	2.6	2.6
6. Financial Institutions	0.8	0.9	0.8	0.7	0.8	0.8	0.9	0.9
7. Corporates	1.1	1.1	1.1	1.3	1	1.1	0.9	1.1
8. FPIs	3.8	3.1	3.5	4.3	4.6	4.5	4.4	3.8
9. Provident Funds	6.3	6.2	6.3	6.1	6	5.3	5.9	5.8
10. RBI	14.8	14.6	14.7	14.3	12.8	11.9	11.6	11.6
11. Others	5.8	5.8	6	6.1	6.1	6.9	6.3	6.6
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: RBI

CHAPTER 2

IMPACT OF VARIOUS POLICIES OF FINANCIAL MARKETS

LEARNING OUTCOMES

After going through the chapter student shall be able to understand

- Credit Policy of RBI
- Fed Policy
- Inflation Index, CPI, WPI, etc.

1. CREDIT POLICY OF THE RESERVE BANK OF INDIA (RBI)

1.1 Meaning of Credit Policy

The credit policy is basically a plan of action executed by the Reserve Bank of India (RBI) on behalf of the Government of India to control and regulate the demand for and supply of money with the public and the flow of credit i.e. money into the economy. It refers to the use of credit policy instruments which are at the disposal of central bank to regulate the availability, cost and use of money and credit to promote economic growth, price stability, optimum levels of output and employment, balance of payments equilibrium, stable currency or any other goal of government's economic policy.

1.2 Objectives of Credit Policy

The various objectives of Credit Policy are as follows:

(i) Maintenance of Price Stability – One of the foremost responsibilities of RBI is to control inflation and maintain the stability of prices.

(ii) Achieving Economic Growth – It is also one of the most important objectives of Credit Policy of RBI. The purpose is to achieve economic growth through various means which will be discussed later. Infact, the primary objective is to maintain a judicious balance between maintenance of price stability and achieving economic growth. So, achieving economic growth is not a direct objective. GDP growth and job creation is primarily the government function. Credit policy is primarily targeted to keep inflation in check and maintain sufficient liquidity in the system which will spur demand. This will lead to economic growth.

(iii) Exchange Rate Stability –The aim is to maintain exchange rate stability so the import is cheaper and exporters increase their export and earn precious foreign exchange.

(iv) External Balance of payment equilibrium – The balance of payment is basically economic transactions of the residents of a country with the rest of the world during a given period of time.When we add up all the demand for foreign currency and all the sources from which it comes, these two amounts are necessarily equal and thus the overall account of the balance of payments necessarily balance or must always be in equilibrium.

(v) Adequate flow of credit to productive sectors – It is the responsibility of the Central Bank to ensure that regular, easy and smooth availability of money to the needy sector of the economy is rendered on a continuous basis. This will help the industry to pump in the required money to boost up their production. This will automatically increase employment as the companies will hire more people to enhance their capacity. This in turn will lead to higher standard of living for the people.

(vi) Maintaining a moderate structure of interest rates to enhance investments –The RBI plays an important role in management of rate of interest. And, the fate of many industries depends upon the interest rate policy pursued by the Central Bank. They expect that interest rates be reduced so that loans can be available at cheaper rate. On the other hand, in case of inflation, general perception is to increase the rate of interest. Therefore, the RBI evaluates the pros and cons of its every prospective decision and decides interest rate policy to be pursued.

Hence, the role of RBI is to tread on a cautious path. People expect that inflation shall be contained and stay within a reasonable limit so that goods and services are available to them in a cheap manner. At the same time, people expect that unemployment should be reduced and more and more jobs should be available. So, tradeoff is required between controlling inflation and rising unemployment.

1.3 Analytics of Credit Policy

There are basically four different mechanisms through which monetary policy influences the price level and the national income. These are:

(i) Interest Rate Channel – Interest rates increases the cost of capital and real cost of borrowing for firms with the result that they cut back on their investment expenditures. Similarly, general public facing the heat of high interest rate cut back on their purchase of homes, cars, airconditioners and other goods. So, a decline in aggregate demand results in the decline in aggregate output and goods.

On the other hand, decrease in interest rates has the opposite effect of decrease in cost of capital of firms and cost of borrowing for households.

(ii) Exchange Rate Channel – Appreciation of the domestic currency makes domestically produced goods more expensive compared to foreign-produced goods. The reason is that import from countries outside India will become cheaper and it will make the goods produced in India dearer in comparison. This will cause the net export to fall (because expensive good produced in India will have to be sold at a higher price and it will find few takers outside India). Consequently, domestic output and employment will also fall.

(iii) Quantum Channel (relating to money supply and credit) –Two things are worth mentioning in this regard – the bank lending (credit) channel and the balance sheet channel. Credit channel operates by altering the access of firms and households to bank credit. Most of the business organizations depend on bank loans for their borrowing needs. To restrict the flow of credit in times of inflation, the RBI sells government securities to commercial banks and the public and squeeze money from them. This makes the firms which are dependent on bank loans to cut back on their spending on investment. This will diminish aggregate output and employment following a reduction in money supply.

Now, we shall look at how the balance sheet channel works. The direct effect of monetary policy on balance sheet is that it will show the interest cost and increase in payments through loan repayments. An indirect effect is that the same increase in interest rate works to reduce the capitalized value of the firm's fixed assets. This will also raise the company's cost of capital and consequently, precipitate reduction in production and output.

(iv) Asset Price Channel – The standard asset price channel indicates that changes in credit policy effects output, employment and inflation. An increase in interest rates in debt securities makes them more attractive to investors than equity. This leads to a fall in the share prices which resulted in the consequent fall in the consumption, production and employment. These also affect the overall financial wealth of the investors.

1.4 Operating Procedure and Instruments

The operating framework of monetary policy refers to how the various aspects of monetary policy are implemented. These aspects are briefly explained as below:

Choosing the operating target –The operating target to the variable (for e.g. inflation) that monetary policy can influence with its actions.

Choosing the intermediate target - (e.g. economic stability) is a variable which central bank can hope to influence to a reasonable degree.

Choosing the policy instruments -The credit policy instruments are the various tools that a central bank can use to influence money market and credit conditions and pursue its monetary policy objectives.

The day to day implementation of monetary policy by central banks through various instruments is referred to as 'operating procedures'.

1.5 The instruments of Credit Policy

The various credit policy instruments are explained in the following paragraphs:

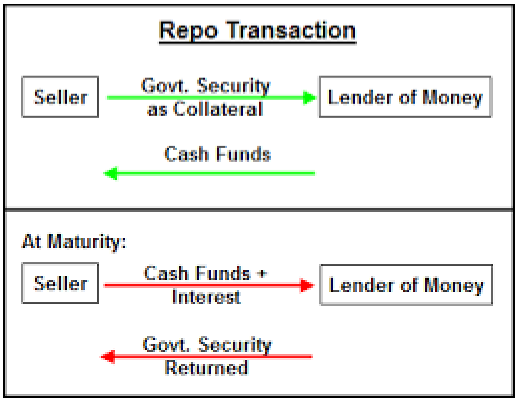
(i) Cash Reserve Ratio (CRR): Cash reserve ratio is the amount which the commercial banks have to maintain as cash deposit with the Reserve Bank of India. RBI may increase the CRR if it thinks that there is large amount of money supply in the economy. Conversely, it will decrease the CRR if it is of the opinion that inflation is in control and the industry needs a monetary boost up. The reduction in CRR will provide more money in the hands of commercial banks which it will pass it on to the industry. More money in the hands of industry will boost up production, consumption and employment. The cash reserve ratio as on 22ndAugust, 2017 is 4%.

(ii) Statutory Liquidity Ratio (SLR): Statutory Liquidity Ratio is the amount which commercial banks have to keep it with itself. So, SLR is the amount of money which banks have to keep in its custody at all times. SLR is also a very powerful tool to control liquidity in the economy. To encourage industries to boost up their production, SLR may be decreased to put more money in the hands of commercial banks. An increase in SLR is used as an inflation control measure to control price rise.

Maintenance of CRR and SLR are a part of what is known as the 'Fractional Reserve System' in Central Banking. Fractional Reserves are a part of the wider Quantitative Monetary Policy.

(iii) Liquidity Adjustment Facility (LAF): Under this facility, the commercial banks can borrow from RBI through the discount window against the collateral of securities like commercial bills, treasury bills or other eligible papers. Currently, the RBI provides financial accommodation to the commercial banks through repos/reverse repos under the LAF.

Repo is defined as an instrument through which commercial banks borrow from RBI. So, for borrowing funds by selling securities with an agreement to repurchase the securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed. In other words, repo is a money market instrument, which enables collateralized short term borrowing and lending through sale/purchase operations in debt instruments.



Source: https://www.assignmentpoint.com/business/finance/repurchase-agreement-definition.html

Reverse Repo, on the other hand, is an instrument thorough which RBI borrows from commercial banks by giving them securities. So, reverse repo is defined as an instrument for lending funds by purchasing securities with an agreement to resell the securities on a mutually agreed future date at an agreed price which includes interest for the funds lent.

(iv) Margin Standing Facility (MSF): Margin Standing Facility announced by the Reserve Bank of India (RBI) in its Monetary Policy, 2011-12 refers to the facility under which scheduled commercial banks can borrow additional amount of overnight money from the central bank over and above what is available to them through the LAF facility upto a limit at a penal rate of interest.

The minimum amount which can be assessed through MSF is ₹ 1 crore and more will be available in multiples of ₹ 1 crore. The MSF would be the last resort for banks once they exhaust all borrowing options including the liquidity adjustment facility on which the rates are lower compared to the MSF.

(v) Market Stabilization Scheme: Under the market stabilization scheme, the Government of India borrows from the RBI and issues treasury bills/dated securities for absorbing excess liquidity from the market arising from large capital inflows. Now, with the introduction of Liquidity Adjustment Facility (LAF) i.e. Repo and Reverse Repo mechanism, bank rate has become dormant as an instrument of monetary policy.

The bank rate has been aligned to the Marginal Standing Facility (MSF) rate and therefore, as and when the MSF rate changes alongside policy repo rate changes, the bank rate also changes automatically. Now, bank rate is used only for calculating penalty on default in the maintenance of Cash Reserve Ratio (CRR) and the Statutory Liquidity Ratio (SLR).

(vi) Open Market Operations: Open Market Operation is basically a tactic employed by the RBI to control the liquidity in the economic system. When the RBI feels there is excess liquidity in the market, it resorts to sale of securities thereby reducing excess rupee flowing in the Indian economy. Similarly, when there is tight liquidity situation in the economy, the RBI will buy securities from the market, thereby releasing money (rupee) into the system.

2. FED POLICY

2.1 About the Federal Reserve System

The Federal Reserve System is the Central Bank of the United States.

It performs five general functions to promote the effective operation of the U.S. economy and, more generally, the public interest. The Federal Reserve:

- **conducts the nation's monetary policy** to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy;
- **promotes the stability of the financial system** and seeks to minimize and contain systematic risks through active monitoring and engagement in the U.S. and abroad;
- **promotes the safety and soundness of individual financial institutions** and monitors their impact on the financial system as a whole;
- **fosters payment and settlement system safety and efficiency** through services to the banking industry and the U.S. government that facilitate U.S. dollar transactions and payments; and
- **promotes consumer protection and community development** through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations.

2.2 Fed Policy Tools

The techniques or tools employed by the US Federal Reserve as a part of Fed Policy have been discussed in brief in the following paragraphs. The purpose of the Fed Policy tools is more or less the same as employed by the Reserve Bank of India which has been discussed in detail in the preceding paragraphs.

(i) Open Market Operations: Open market operations (OMOs)--the purchase and sale of securities in the open market by a central bank--are a key tool used by the Federal Reserve in the implementation of monetary policy.

(ii) The Discount Rate: The discount rate is the interest rate charged to commercial banks and other depository institutions on loans they receive from their regional Federal Reserve Bank's lending facility--the discount window. The Federal Reserve Banks offer three discount window programs to depository institutions: primary credit, secondary credit, and seasonal credit, each with its own interest rate. All discount window loans are fully secured.

Under the primary credit program, loans are extended for a very short term (usually overnight) to depository institutions in generally sound financial condition. Depository institutions that are not eligible for primary credit may apply for secondary credit to meet short-term liquidity needs or to resolve severe financial difficulties. Seasonal credit is extended to relatively small depository institutions that have recurring intra-year fluctuations in funding needs, such as banks in agricultural or seasonal resort communities.

(iii) Reserve Requirements: Reserve requirements are the amount of funds that a depository institution must hold in reserve against specified deposit liabilities. Within limits specified by law, the Board of Governors has sole authority over changes in reserve requirements. Depository institutions must hold reserves in the form of vault cash or deposits with Federal Reserve Banks.

(iv) Interest on Required Reserve Balances and Excess Balances: The Federal Reserve Banks pay interest on required reserve balances and on excess reserve balances. The interest rate on required reserves (IORR rate) is determined by the Board and is intended to eliminate effectively the implicit tax that reserve requirements used to impose on depository institutions.

(v) Overnight Reverse Repurchase Agreement Facility: When the Federal Reserve conducts an overnight RRP, it sells a security to an eligible counterparty and simultaneously agrees to buy the security back the next day.

(vi) Term Deposit Facility: Funds placed in term deposits are removed from the reserve accounts of participating institutions for the life of the term deposit and thereby drain reserve balances from the banking system.

(Source: www.federalreserve.gov)

2.3 Fed Funds Rate and its impact on Global Financial Market

The Fed Funds Rate is the interest rate at which the top US banks borrow overnight money from common reserves. All American banks are required to park a portion of their deposits with the Federal Reserve in cash, as a statutory requirement.

Actually, fed fund rate gives the direction in which US interest rates should be heading at any given point of time. If the Fed is increasing the interest rates, lending rates for companies and retail borrowers will go up and vice versa. In India, hike in repo rate may not impact the countries outside India. On the other hand, US interest rates matter a lot to global capital flows. Some of the world's richest institutions and investors have their base in USA. They constantly compare Fed rates with interest rates across the world to make their allocation decisions.

Any changes in the Fed Fund Rates impact the domestic borrowing market to a large extent. For instance, if the Fed rates go up, it will make the RBI hesitant in cutting rates at that time. The reason is that if RBI cut rates it will lead to heavy pullout of foreign investors from the Indian bond market.

Further, US interest rates matter to foreign stock investors in India also. The reason is zero or near zero returns on safe investments in the US. But, if the Fed rates go up, it may lead to mass exodus of foreign investors from the Indian Stock Market because higher returns in the form of interest is available there.

3. COST INFLATION INDEX (CII)

Cost Inflation Index is a measure of inflation that is used for computing long-term capital gains on sale of capital assets. It is prescribed by the central government every year and useful in the calculation of the indexed value of the capital assets. It helps a tax payer in computing the actual long term gain or loss on selling of capital assets and also allows the tax payer to factor the impact of inflation on the cost of their asset.

To calculate the indexed cost of acquisition we have to divide the Cost Inflation Index or CII for year in which asset is sold by the Cost Inflation Index or CII for a year in which asset is bought, then multiplied with the purchase price of the asset to arrive at the indexed cost of acquisition which is the actual or true cost used at the time of tax computation.

Since the government levies a tax on such transactions, the owner would be required to pay a large amount as tax. In order to avoid paying a large sum towards tax, the purchase price of the asset can be indexed to show the asset's value as per its current value, taking into account inflation by increasing its value. In this manner, the profit derived from the sale would be lower, thus reducing the capital gains payable.

Thus, indexation helps the actual value of the asset to reflect at its present market rates, taking into account the reduction in its value due to inflation.

When selling an asset, the purchase price is referred to as the indexed cost of acquisition. The cost inflation index (CII), therefore, is the indexed price that the asset is purchased at. The CII for a particular year is fixed by the government and released before the accounting year ends, for the purpose of tax computation.

Computation of Cost Inflation Index

Cost Inflation Index (CII) = CII for the year the asset was transferred or sold / CII for the year the asset was acquired or bought.

The above formula for the computation of CII has been explained with the help of an example:

Example

Suppose, you purchased a house for Rs.25 lakhs in Jan 2005 and sold it for Rs.70 lakhs in Jan 2015. Your profit or capital gain is Rs.45 lakhs.

The CII for the year the apartment was bought in is 406. The CII for the year the apartment was sold is 1081.

Now, the cost inflation index = CII for the year the asset was transferred or sold / CII for the year the asset was acquired or bought = 1081/406 = 2.66

While computing tax, CII is multiplied with the purchase price to arrive at the indexed cost of acquisition. This is the actual cost of the asset.

Therefore, the indexed cost of acquisition = 25, 00,000 X 2.66 = Rs.66,50,000

And, the long term capital gain = sale value of the asset - indexed cost of acquisition

= 70,00,000 –66,50,000 = Rs.3,50,000

The tax liability if you use the indexation method is charged at 20 percent. The tax liability will be 20% X 3,50,000= Rs.70000.

If you do not use the indexation method, the tax is payable at 10% on the capital gain. The capital gain in this case is sale price of the apartment – cost of acquisition = 70,00,000 – 25,00,000 = ₹ 45,00,000. The capital gains tax is 10% x 45,00,000 = ₹ 4,50,000.

Therefore, when indexation benefit is taken, it helps you in saving taxes. It helps you adjust the purchase price of the house with the current market prices.

4. CONSUMER PRICE INDEX (CPI)

A Consumer Price Index (CPI) is designed to measure the changes over time in general level of retail prices of selected goods and services that households purchase for the purpose of consumption. Such changes affect the real purchasing power of consumers' income and their welfare. The CPI measures price changes by comparing, through time, the cost of a fixed basket of commodities. The basket is based on the expenditures of a target population in a certain reference period. Since the basket contains commodities of unchanging or equivalent quantity and quality, the index reflects only pure price. Traditionally, CPI numbers were originally introduced to provide a measure of changes in the living costs of workers, so that their wages could be compensated to the changing level of prices. However, over the years, CPIs have been widely used as a macroeconomic indicator of inflation, and also as a tool by Government and Central Bank for targeting inflation and monitoring price stability. CPI is also used as deflators in the National Accounts. Therefore, CPI is considered as one of the most important economic indicators.

Given the many uses of CPIs, it is unlikely that one index can perform equally satisfactory in all applications. Therefore, there is a practice of compiling several CPI variants for specific purpose. Each index should be properly defined and named to avoid confusion. The purpose of CPI should influence all aspects of its construction.

4.1 Classification of Items

Classification is the first step in compiling the CPI because its sub-aggregates must be defined in such a way that expenditure weights and prices will relate precisely to the coverage of the sub-aggregates. It establishes a hierarchical framework from whose boundaries the representative items for inclusion in the index (and sometimes the outlets) will be defined and drawn. In broad sense, a classification is a procedure in which items are organized into categories based on information on one or more characteristics inherent to the items. In years past, countries used their own distinct systems for classifying the range of products covered by their CPI. Most countries have now, however, moved to the international standard classification COICOP (Classification of Individual Consumption according to Purpose).

In order to ensure better comparability with CPIs of other countries, it is desirable to have the classification of items synchronized with COICOP. At the same time, it is also important to make it relevant to the Indian context by making it comparable to groups and sub-groups being followed in the CPI series compiled in the country. Accordingly, all consumption items have been classified under various Groups, Categories, Sub-groups and Sections.

(Source: Ministry of Statistics and Programme Implementation)

4.2 Issues relating to Consumer Price Index (CPI)

Some of the issues relating to Consumer Price Index (CPI) which have been in vogue for quite some time have been discussed in the following points in order to have a good glimpse of the actual impact of CPI to the consumers in India.

(1) 90-95% of the index (CPI) is not affected by interest rates as the amount spent on household is not affected by the rate changes. This includes food products (covering 48% in index), housing or fuel expenses. These are fixed cost and had to be spent irrespective of the rate of inflation.

(2) Concept of CPI does not make sense to the household. A 2% CPI does not seem convincing to a housewife who believes that prices of most of the commodities are on the higher side than that reflected by CPI. So, it is frustrating for the consumer who after every fall in rate of inflation finds that actual prices are on the much higher side.

For example, prices of tomatoes suddenly increase from ₹ 30 per kg. to₹ 80 per kg. Similarly, the prices of Tur Dal increases from ₹ 40 per kg. to ₹ 200 per kg in a very short span of time. However, prices came down slowly and now it is ₹ 80-90 per kg. So, prices increases at a very fast rate but came down after taking a lot of time and that too, the reduced price is generally at a much higher level than the previous one, as explained in the previous sentence with the help of an example.

(3) Lastly, a general view is that HRA allowance paid to Central Government employees would tend to raise inflation. However, if the government employee is residing in a government accommodation, HRA is automatically deducted form the pay slip of an employee. On the other hand, if employee is not staying in a government accommodation the amount in the pay slip will goes up. Therefore, increase in HRA may not translate into higher cost of living or higher retail demand.

5. WHOLESALE PRICE INDEX (WPI)

Wholesale Price Index (WPI) measures the average change in the prices of commodities for bulk sale at the level of early stage of transactions. The index basket of the WPI covers commodities falling under the three major groups namely Primary Articles, Fuel and Power and Manufactured products. (The index basket of the present 2011-12 series has a total of **697** items including **1**17 items for Primary Articles, **16** items for Fuel & Power and **564** items for Manufactured Products.) The prices tracked are ex- factory price for manufactured products, mandi price for agricultural commodities and ex-mines prices for minerals. Weights given to each commodity covered in the WPI basket is based on the value of production adjusted for net imports. WPI basket does not cover services.

In India WPI is also known as the headline inflation rate.

The base year of all India WPI has been revised from 2004-05 to 2011-12 by the Office of the Economic Advisor, Department of Industrial Policy and Promotion, Ministry of Commerce and Industry.

In India, Office of Economic Advisor (OEA), Department of Industrial Policy and Promotion, Ministry of Commerce and Industry calculates the WPI.

The main uses of WPI are the following:

(1) To provide estimates of inflation at the wholesale transaction level for the economy as a whole. This helps in timely intervention by the Government to check inflation in particular, in essential commodities, before the price increase spill over to retail prices.

(2) WPI is used as deflator for many sectors of the economy including for estimating GDP by Central Statistical Organisation (CSO).

(3) WPI is also used for indexation by users in business contracts.

(4) Global investors also track WPI as one of the key macro indicators for their investment decisions.

Difference between Wholesale Price Index (WPI) and Consumer Price Index (CPI)

WPI reflects the change in average prices for bulk sale of commodities at the first stage of transaction while CPI reflects the average change in prices at retail level paid by the consumer.

The prices used for compilation of WPI are collected at ex-factory level for manufactured products, at ex-mine level for mineral products and mandi level for agricultural products. In contrast, retail prices applicable to consumers and collected from various markets are used to compile CPI.

The reasons for the divergence between the two indices can also be partly attributed to the difference in the weight of food group in the two baskets. CPI Food group has a weight of 39.1 per cent as compared to the combined weight of 24.4 per cent (Food articles and Manufactured Food products) in WPI basket.

The CPI basket consists of services like housing, education, medical care, recreation etc. which are not part of WPI basket. A significant proportion of WPI item basket represents manufacturing inputs and intermediate goods like minerals, basic metals, machinery etc. whose prices are influenced by global factors but these are not directly consumed by the households and are not part of the CPI item basket.

Thus even significant price movements in items included in WPI basket need not necessarily translate into movements in CPI in the short run. The rise or fall in prices at wholesale level spill over to the retail level after a lag.

Similarly, the movement in prices of non-tradable items included in the CPI basket widens the gap between WPI and CPI movements. The relative price trends of tradable vis a vis non-tradable is an important explanatory factor for divergence in the two indices in the short term.

(Source: Arthapedia)

CHAPTER 3

CAPITAL MARKET - PRIMARY

LEARNING OUTCOMES

After going through the chapter student shall be able to understand

- Basics of Capital Market
- Segments of Capital Market
- Capital Market Instruments
- Aspects of Primary Market
  - (1) Different kinds of issue of securities
  - (2) Types of offer document
  - (3) Issue requirements
  - (4) Steps in Public Issue
  - (5) Book Building
  - (6) ASBA
  - (7) Green Shoe Option
  - (8) Anchor Investors
  - (9) Private Placement(includes QIP)
  - (10) Disinvestment
  - (11) Right Issue
  - (12) Exit Offers (Delisting Offers and Strategic Issues)

1. BASICS OF CAPITAL MARKETS (NEED, EVOLUTION AND CONSTITUENTS)

Capital Market is basically a part of financial market where buying and selling of long term debt or equity takes place. The main role of capital market is providing a platform where long term funds are raised. This fund raising exercise through the capital market is tapped by the governments, banks and corporates through the capital market. Therefore, the organizations which need money can raise funds with the help of the capital market by issuing shares and debentures. The investors then invest in the capital market by purchasing those shares and debentures.

Therefore, it appears from the above that capital market acts as a link between savers and investors. It plays an important role in mobilizing the savings of the investors and channelizing them for productive purposes. So, the capital markets serves an important purpose as it helps in diverting the resources from where surplus funds are available to areas where there is dearth of funding and money is needed on urgent basis.

So, we can say that capital market is the soul of an economy through which savings of people are invested in basically corporate form of organizations. And, corporates utilize such invested amounts by putting them to their most effective use by allocating them in profitable opportunities. Therefore, a vibrant capital market benefits both the investor as well as the corporate form of organization and it is an important indicator of economic health of a country.

In order to ensure that capital market work in an orderly manner, Securities and Exchange Board of India (SEBI) act as a watchdog to protect investors against market manipulation, unfair trading and fraud amongst others. The job of SEBI is to protect the interests of investors and guide them to make wise investment decisions. The task of SEBI is also to ensure that the companies follow it's rules, regulations and guidelines diligently and help to make the Indian Capital Market best in the world in terms of transparency and investor friendly measures.

The Indian Capital Market is very old. It started in 18th Century when the Indian securities are traded in Mumbai and Kolkata. However, the actual trading of securities in Indian Capital Market started with the setting up of The Stock Exchange of Bombay in July 1875 and Ahmedabad Stock Exchange in 1884. The evolution and development of Indian Capital Market can be discussed under two categories:

(i) Indian Capital Market – Before 1990's

(ii) Indian Capital Market – After 1990's

1.1 Indian Capital Market – Before 1990's

The Indian Capital Market was very inactive till 1990. The requirements of loan term loan of corporate sector were funded by Development Financial Institutions (DFI's) namely IDBI, IFCI, ICICI as well as by other investment institutions like LIC, UTI, GIC etc. Working capital requirements were funded by the Commercial Banks through an elaborate network of bank branches spread all over the country.

The scope of capital market was limited because of easy availability of loans from banks and financial institutions. The structure of interest rate was entirely controlled. But, three important legislations, namely, Capital Issues (Control) Act 1947, Securities Contracts (Regulation) Act, 1956, and Companies Act, 1956 (Now, Companies Act, 2013) were somehow managed to give a proper structure for the development of capital market in India. However, the market was a highly regulated one. The pricing of the securities which were issued to the public for the first time was decided by the Office of the Controller of Capital Issues. There were few stock exchanges and the dominant one was Bombay Stock Exchange (BSE). The BSE provided the trading platform under which the secondary market transactions operate under an open outcry system.

1.2 Indian Capital Market – After 1990's

The Indian capital markets have witnessed a major transformation and structural change during the past two and a half decades, since the early 1990's. The Financial Sector Reforms in general and the Capital Market Reforms in particular were initiated in India in a big way from 1991 – 1992 onward. These reforms have enabled the capital market to improve its efficiency, to enhance transparency in market operations, to check unfair trade practices and bring the Indian capital market in accordance with the International Standards. The Capital Issues (Control) Act, 1947 was repealed in May 1992, and the office of the Controller of Capital Issues was abolished in the same year. The incorporation of National Stock Exchange was happened in 1992. After that it was recognized as a Stock Exchange in April 1993. It has been playing a lead role as a change agent in transforming the Indian Capital Market to its present form.

The Securities and Exchange Board of India (SEBI) was set up in 1988 and acquired the statutory status in 1992. Since 1992, SEBI has emerged as an autonomous and independent statutory body with definite mandate such as:

(a) to protect the interests of investors in securities,

(b) to promote the development of securities market, and

(c) to regulate the securities market.

In order to achieve these objectives, SEBI has been exercising power under the Securities and Exchange Board of India Act, 1992; Securities Contracts (Regulation) Act, 1956; Depositories Act, 1996 and delegated powers under the Companies Act, 2013. Indian Capital Market has made commendable progress since the inception of SEBI and has been transformed into one of the most dynamic capital markets of the world.

1.3 Functions of the capital market

The major functions of capital market are:

1. To mobilize resources for investments.

2. To facilitate buying and selling of securities.
3. To facilitate the process of efficient price discovery.
4. To facilitate settlement of transactions in accordance with the predetermined time schedules.

1.4 Major constituents of the capital market

1. SEBI (regulator)
2. Stock exchanges
3. Clearing corporations (cc)/ clearing houses (ch)
4. Depositories and depository participants
5. Custodians
6. Stock-brokers and their sub-brokers
7. Mutual funds
8. Merchant bankers
9. Credit rating agencies
10. Financial institutions
11. Foreign institutional investors
12. Non-banking institutions
13. Issuers/ registrar and transfer agents
14. Investors

2. SEGMENTS OF CAPITAL MARKET

2.1 Primary Market

Primary market is a market where buying and selling of new securities are taken place for the first time. In other words, the market, where the first public offering of equity shares or convertible securities by a company take place which is followed by the listing of a company's shares on a stock exchange is called a primary market. It is also known as 'initial public offering' (IPO). Issue of further capital by companies whose shares are already listed on the stock exchange also comes within the ambit of Primary market.

There are different types of intermediaries operating in this segment of capital market by providing a variety of services. For example, merchant bankers, brokers, bankers to issues, debenture trustees, portfolio managers, registrars to issues and share transfer agents, etc. They are also regulated by SEBI. Their contribution is immense in the development of capital market.

2.2 Secondary Market

Secondary market is a market in which purchase and sale of securities which are already issued to the public for the first time and listed on the stock exchange takes place. Therefore, secondary markets are called stock exchanges and the over-the-counter market. When the securities are transferred from the first holder to another, the securities are said to be traded in secondary markets.

2.3 Primary Market vs. Secondary Market

Both the primary and secondary markets are approached by the corporates for funding their capital requirements. While the functions in the primary stock exchange are limited to first issuance, a number of securities and financial assets can be traded and retraded over and over again. The main difference between the two is that, in the primary market, the involvement of company is directly in the transaction, while in the secondary market, the company has no involvement because the transactions take place between the investors.

2.4 The difference between primary market and secondary market

1. The Primary market refers to the market in which new securities are issued by the company to the public for the first time while the secondary market refers to the market where new securities which are already issued are traded. Stocks, bonds, options and futures are usually traded on the secondary market.

2. There is direct involvement of the company in the primary market. Whereas, in the secondary market, the company has virtually no involvement since the transactions takes place between investors.

3. The primary markets deal with new securities, that is, securities, which were not previously available and are, therefore, offered to the investing public for the first time while the secondary market is a market for already issued securities.

4. Primary market provides additional funds to the issuing companies either for starting a new enterprise or for the expansion or diversification of the existing business. On the other hand, the secondary market can in no circumstance supply additional funds since the company is not involved in the transaction.

2.5 Similarities between Primary and Secondary Markets

Some of the similarities between them are as follows:

(a) **Listing:** The securities issued in the primary market are invariably listed on a recognized stock exchange for dealings in them. Further trading in secondary market can also be carried out only through the stock exchange platform. The listing on stock exchanges provides liquidity as well as marketability to the securities and facilitates discovery of prices for them.

(b) **Control by Stock Exchanges:** Via the mechanism of Listing Agreement between the issuer companies and the stock exchange, the stock exchanges exercise considerable control over the new issues as well securities already listed on the stock exchange. Stock Exchanges ensure that there is continuous compliance by the issuer company of the clauses provided in the Listing Agreement.

2.6 Interrelationship between Primary Markets and Secondary Markets

The markets for new and old securities are, economically, an integral part of a single market – the capital market. Their mutual interdependence from the economic point of view has following two dimensions:

- ❖ One, the quantum of trading and the participation of the investors on stock exchange has a significant bearing on the level of activity in the primary market and, therefore, its responses to capital issues.
- ❖ Second, the dimension of mutual interdependence is based on the fact that the level of activity in primary market has a direct impact on the level of activity in secondary market. As more and more companies issue their securities in the capital market, investment options for investors increase which leads to a wider participation by investors in the secondary market.

2.7 Participants in the Capital Market

- ❖ *Investors:* Investors are the lifeline of any capital markets. For a vibrant capital market, the capital market should be able to attract the savings of investors. Investors belong to various categories such as Retail Investors, Institutional Investors like mutual funds, insurance companies and Foreign Portfolio Investors.
- ❖ *Stock Exchange:* Stock Exchange is a place where securities issued by issuer companies are listed and traded. The term is synonymously used for secondary markets.
- ❖ *Depository:* A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered Depository Participant. They also provide safekeeping of securities. They also help in other functions like pledge, hypothecation, stock lending and borrowing etc. In India there are two depositories namely National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL).
- ❖ *Intermediaries:* Intermediaries are those entities which offer various services in relation to the capital markets. There are various categories of intermediaries such as stock brokers, merchant bankers, underwriters etc.

3. CAPITAL MARKET INSTRUMENTS

Financial instruments (e.g. bonds and stocks) whose maturity is more than one year are traded in the capital market. They are a very large source of funds with bonds having long maturity and shares having indefinite maturity. It also helps in increasing capital formation in the country. The following instruments are available for investors in the capital market:-

- Shares (Equity and preference)
- Debentures/ Bonds
- Depository Receipts (ADR's, GDR's and IDR's)
- Derivatives

The above instruments are discussed as below:

(i) Shares: Share is a type of security, which signifies ownership in a corporation and represents a claim on the part of the corporation's assets and earnings. As one acquires more shares, his or her ownership stake in the company becomes greater.

There are two main types of shares, equity shares and preference shares. Equity share usually entitles the owner to vote at shareholders' meetings and to receive dividends. Preference shares generally do not have voting rights, but have a prior preference on assets and earnings of the company than the equity shares. For example, an owner of Preference shares receive dividends before equity shareholders and have priority in the event of a company goes bankrupt or is liquidated.

Basic Features of Shares

It is a general belief that on becoming a shareholder of a company, the shareholder has a say in the day to day running of the business. However, on the contrary, an individual retail investor has very little control over the running of the business. Various features of shares are laid down as below:

1) Profits are sometimes paid out in the form of dividends. Higher proportion of shares in a company signifies higher stake in the profits also. In case of bankruptcy and liquidation, you'll receive what's left after all the creditors have been paid.
2) Another extremely important feature of share is its limited liability, which means that, as an owner of a share, you are not personally liable if the company is not able to pay its debts.
3) Companies issue shares to raise capital as it does not require the company to pay back the money after a certain time period (other than redeemable preference shares) or make interest payments continuously. Equity shares can be held by the company till perpetuity.
4) Equity shares are traded on the cash segment of the capital market. The investors in equity shares make money via dividends or through capital appreciation in the price of the shares.

Equity shares are very high risk instruments with no guaranteed returns. There is always a risk of downside in the value of equity investments.

5) Shares are traded at market value on stock exchanges. Market Value per share is the current price at which the share is traded. For actively traded stocks (liquid stocks), market price quotations are readily available due to continuous demand and supply for those shares .However for inactive stocks (illiquid stocks) that have very thin markets, prices are very difficult to obtain. Even when obtainable, the information may reflect only the sale of a few shares and not typify the market value of the firm as a whole. Market value per share of an equity share is generally a function of the expectations of the market about the future earnings of the company and the perceived risk on the part of investors.

(ii) Preference Shares: These shares form part of the share capital of the company which carry a preferential right to be paid in case a company goes bankrupt or is liquidated. Preference shareholders have got very negligible voting rights. But they do have a higher claim on the assets and earnings of the company.

(iii) Debentures/ Bonds: One of the most popular long term debt securities among corporates is bond. In case of a bond issue, the buyer of bonds lends the required amount to the issuer of bonds. The certificate itself is evidence of a lender-creditor relationship. It is a "security" because unlike a car loan or home-improvement loan, the debt can be bought and sold in the open market. And bond is a security which can be bought and sold in the open market. In fact, as already mentioned, bond is a long term security whose maturity period is generally more than one year. Bonds with maturities less than one year are generally called money market instruments.

As the intention of a bond issue is that the securities shall be bought and sold, all the certificates of a bond issue contain a master loan agreement. This agreement between issuer and investor (or creditor and lender), called the 'bond indenture" or "deed of trust," contains all the information one would normally expect to see in any loan agreement, which includes the following:

- ***Amount of the Loan:*** The "face amount" "par value" or "principal" is the amount of the loan - the amount that the bond issuer has agreed to repay at the bond's maturity.

- ***Rate of Interest:*** Bonds are issued with a specified "coupon" or "nominal" rate, which is determined largely by market conditions at the time of the bond's primary offering. So, once the coupon rate is fixed, it is applicable for the entire life of the bond. The amount of the interest to be paid can be arrived at by multiplying the rate of interest (coupon) by the face value of the bond. For example, the interest which a bond issuer pays to the bondholder in case of a bond issue with face value of ₹ 100,000 and a coupon of 8% is ₹ 8000 per year.

- ***Schedule or Form of Interest Payments:*** Interest is paid on most bonds at six-month intervals, usually on either the first or the fifteenth of the month. The ₹ 8000 of annual interest on the bond in the previous example would probably be paid in two installments of ₹ 4000 each.

- ***Term:*** A bond's "maturity," or the length of time until the principal is repaid varies greatly but is always more than five years. Debt that matures in less than a year is a "money market instrument" - such as commercial paper or bankers' acceptances. A "short-term bond," on the other hand, may have an initial maturity of five years. A "long- term bond" typically matures in 20 to 40 years. The maturity of any bond is predetermined and stated in the trust indenture.

- ***Call Feature (if any):*** A "call feature," if specified in the trust indenture, allows the bond issuer to "call in" the bonds and repay them at a predetermined price before maturity. Bond issuers use this feature to protect themselves from paying more interest than they have to for the money they are borrowing. Companies call in bonds when general interest rates are lower than the coupon rate on the bond, thereby retiring expensive debt and refinancing it at a lower rate.

  Suppose, IDBI had issued 6 years ₹ 1000 bonds in 1998 @14% p.a. But now the current interest rate is around 9% to 10%. If the issuer wants to take advantage of the call feature in the bond's indenture it will call back the earlier issued bonds and reissue them @9% p.a. The sale proceeds of this new issue will be used to pay the old debt. In this way IDBI now enjoys a lower cost for its borrowed money.

  Some bonds offer "call protection"; that is, they are guaranteed not to be called for five to ten years. Call features can affect bond values by serving as a ceiling for prices. Investors are generally unwilling to pay more for a bond than its call price, because they are aware that the bond could be called at a lower call price. If the bond issuer exercises the option to call bonds, the bond holder is usually paid a premium over par for the inconvenience.

- ***Refunding:*** If, when bonds mature, the issuer does not have the cash on hand to repay bondholders; it can issue new bonds and use the proceeds either to redeem the older bonds or to exercise a call option. This process is called refunding.

Yields and its Method of Calculation : There are number of methods for calculating yields. But the most common method is the Yield to Maturity (YTM). Although this is another name of IRR. The formula is as follows:

$$\text{YTM} = \frac{\text{Coupon Rate} + \dfrac{\text{Redemption Value - Purchase Price}}{\text{Period of Holding}}}{(\text{Redemption Value + Purchase Value})/2}$$

Determinants of Bond Prices: While Yield To Maturity (YTM) enables traders and investors to compare debt securities with different coupon rates and terms to maturity, it does not determine price. Bond prices depend on a number of factors such as the ability of the issuer to make interest and principal payments and how the bond is collateralized. An across-the-board factor that affects bond prices is the level of prevailing interest rates.

Illustration 1

Suppose a 8% ₹ 1000 bond had 5 years left to maturity when it was purchased for ₹ 800. The prevailing interest rate (on other investment vehicles) was about 8%. Further assume that current prevailing interest rates are about 9%. Why should investors buy a five-year old bond yielding 8% when they can buy a newly issued 9% bond?

Solution

The only way the holder of an 8% bond can find a buyer is to sell the bond at a discount, so that its yield to maturity is the same as the coupon rate on new issues. Let's say interest rates increase from 8% to 10%. With 15 years to maturity, an 8% bond has to be priced so that the discount, when amortized over 15 years has a yield to maturity of 10%. That discount is a little under ₹ 200:

$$\text{YTM} = \frac{\text{Coupon Rate} + \text{Prorated Discount}}{(\text{Face Value} + \text{Purchase Price})/2} = \frac{₹\ 80 + (₹\ 200/15 \text{ years})}{(₹\ 1{,}000 + ₹\ 800)/2} = \frac{₹\ 93.33}{₹\ 900} = 10.4\%.$$

The 8% bond with 15 years to maturity must sell at a little over ₹ 800 to compete with 10% bonds. The possibility that interest rates will cause outstanding bond issues to lose value is called "Interest rate risk." Yet there is an upside to this risk. If interest rates decline during the five years that the 8% bond is outstanding, the holder could sell it for enough of a premium to make its YTM rate equal to the lower yields of recent issues. For instance, should Interest rates decline to 7%, the price of the 8% bond with 15 years to maturity will increase by about ₹ 100.

(iv) American Depository Receipt (ADRs): An American Depository Receipt (ADR) is a negotiable receipt which represents one or more depository shares held by a US custodian bank, which in turn represent underlying shares of non-US issuer held by a custodian in the home country. Investors of USA who are willing to invest in the securities of non USA issuers finds ADR as an attractive means of investment for the following reasons:

❖ ADRs provide a means to US investors to trade the non-US company's shares in US dollars. ADR is a negotiable receipt (which represents the non US share) issued in US capital market and is traded in dollars. The trading in ADR effectively means trading in underlying shares.

❖ ADRs facilitate share transfers. ADRs are negotiable and can be easily transferred among the investors like any other negotiable instrument. The transfer of ADRs automatically transfers the underlying share.

❖ The transfer of ADRs does not involve any stamp duty and hence the transfer of underlying share does not require any stamp duty.

❖ The dividends are paid to the holders of ADRs in U.S. dollars.

A non U.S. issuer has to work with its US investment bankers, US depository bank, US and non US legal counsel and independent accountant to prepare the registration documents and offering materials.

The listing of such an issue is done on the NYSE or AMEX to enable trading. Quotations on NASDAQ can also be used for trading purposes. Any requirement with respect to Blue Sky Law, if not exempted, has to be fulfilled.

Specified document and information must be provided to NASDAQ to enable it to review the terms of the offering and determine whether the underwriting arrangements are fair and reasonable. The filing documents with NASDAQ are the responsibility of managing underwriter.

(v) Global Depository Receipts (GDRs): Global Depository Receipts are negotiable certificates issued by a depository based outside India to non-resident investors with publicly traded equity shares or foreign currency convertible bonds of the issuer in India as underlying security. An issue of depository receipts would involve the issuer, issuing agent to a foreign depository. The depository, in turn, issues GDR to investors evidencing their rights as shareholders. Depository receipts are denominated in foreign currency and are listed on an international exchange such as London or Luxembourg. GDR enable investors to trade a dollar denominated instrument on an international stock exchange and yet have rights in foreign shares.

The principal purpose of the GDR is to provide international investors with local settlement. The issuer issuing the shares has to pay dividends to the depository in the domestic currency. The depository has to then convert the domestic currency into dollars for onward payment to receipt holders. GDR bear no risk of capital repayment.

GDR is also issued with warrants attached to them. Warrants give the investors an option to get it converted into equity at a later date. Warrants help the issuer to charge some premium on the GDR sold and it also helps to increase the demand of the GDR issue. The other advantage to the issuer is that it will not have to pay dividends on the warrants till the conversion option is exercised. The disadvantage to the issuer lies in delayed receipt of full proceeds from the issue and in case the conversion option is not exercised the expected proceeds will not be realised.

(vi) Derivatives: A derivative is a financial instrument which derives its value from some other financial price. This 'other financial price' is called the underlying. The most important derivatives are futures and options.

These are derivative instruments traded on the stock exchange. The instrument has no independent value, with the same being 'derived' from the value of the underlying asset. The asset could be securities, commodities or currencies. Its value varies with the value of the underlying asset. The contract or the lot size is fixed. For example, a Nifty futures contract has 50 stocks.

Futures

This means you agree to buy or sell the underlying security at a 'future' date. If you buy the contract, you promise to pay the price at a specified time. If you sell it, you must transfer it to the buyer at a specified price in the future.

The contract will expire on a pre-specified expiry date (for example, it is the last Thursday of the month for equity futures contracts). Upon expiry, the contract must be settled by delivering the underlying asset or cash. You can also roll over the contract to the next month. If you do not wish to hold it till expiry, you can close it mid-way.

Options

This gives the buyer the right to buy/sell the underlying asset at a predetermined price, within, or at end of a specified period. He is, however, not obliged to do so. The seller of an option is obliged to settle it when the buyer exercises his right.

There are two types of options — call and put. Call is the right but not the obligation to purchase the underlying asset at the specified price by paying a premium. The seller of a call option is obliged to sell the underlying asset at the specified strike price. Put is the right but not the obligation to sell the underlying asset at the specified price by paying a premium. However, the seller is obliged to buy the underlying asset at the specified strike price. Thus, in any options contract, the right to exercise the option is vested with the buyer of the contract. The seller only has the obligation.

Investing in F&O needs less capital as you are required to pay only a margin money (5-20 per cent of the contract) and take a larger exposure. However, it is meant for high networth individuals.

In futures contracts, the buyer and the seller have an unlimited loss or profit potential. The buyer of an option can make unlimited profit and faces limited downside risk. The seller, on the other hand, can make limited profit but faces unlimited downside. *(Source: Business Standard)*

4. ASPECTS OF PRIMARY MARKET (NEW ISSUE MARKET)

Various aspects of primary market i.e. new issue market have been discussed in detail in the following paragraphs. Discussion mainly takes places in Indian context. However, global aspects are also covered at suitable places.

4.1 Different kinds of issue of securities

Primarily, issues made by an Indian company can be classified as Public, Rights, Bonus and Private Placement. While right issues by a listed company and public issues involve a detailed procedure, bonus issues and private placements are relatively simpler. The classification of issues is illustrated as below:

a) Public Issue
   (i) Initial Public Offer (IPO)
   (ii) Further Public Offer (FPO)

b) Rights Issue

c) Composite Issue (Combination of public and right issue)

d) Bonus Issue

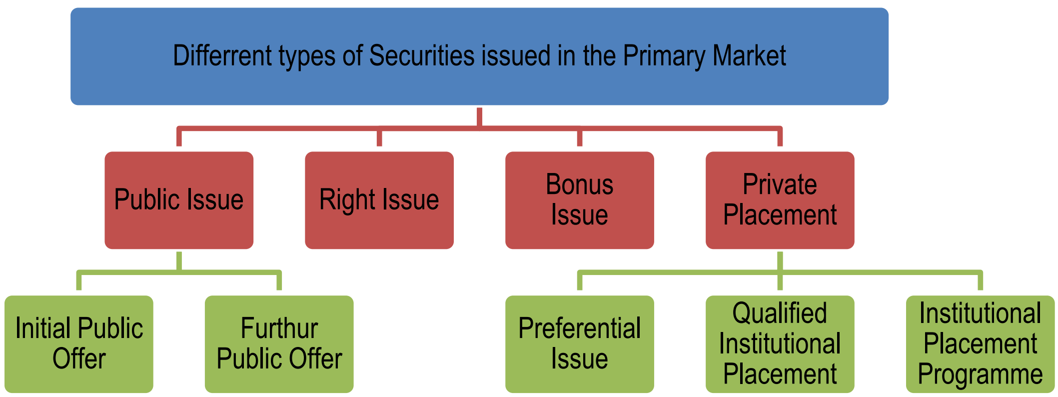
e) Private Placement

(i) Preferential Issue

(ii) Qualified Institutional Placement

(iii) Institutional Placement Programme

Different types of Securities issued in the Primary Market can be succinctly shown in the following diagram:



The diagram as depicted above has been briefly discussed as below:

(a) Public Issue: When shares or convertible securities are issued to new investors, it is called a public issue. Public issue can be further sub-divided into Initial Public Offer (IPO) and Further Public Offer (FPO). The significant features of each type of public issue are illustrated below:

(i) Initial Public Offer (IPO): When the shares and debentures of a company are issued to the public for the first time, it is called an IPO. It then set the stage for listing and trading of the issuer's shares or convertible securities on the Stock Exchanges.

(ii) Further Public Offer (FPO) or Follow on Offer: When an already listed company makes either a fresh issue of shares or convertible securities to the public or an offer for sale to the public, it is called a FPO.

(b) Right Issue (RI): When an issue of shares or convertible securities is made by an issuer to its existing shareholders as on a particular date fixed by the issuer (i.e. record date), it is called a right issue. The rights are offered in a particular ratio to the number of shares or convertible securities held as on the record date.

(c) Composite Issue: When the issue of shares or convertible securities by a listed issuer on public cum-rights basis, wherein the allotment in both public issue and rights issue is proposed to be made simultaneously, it is called composite issue.

(d) Bonus Issue: When an issuer makes an issue of shares to its existing shareholders without any consideration based on the number of shares already held by them as on a record date, it is called a bonus issue. In Bonus Issue, the shares are issued out of the Company's free reserve or share premium account in a particular ratio.

(e) Private Placement: When an issuer makes an issue of shares or convertible securities to a select group of persons not more than 50 but can extend upto 200, it is called a private placement. It should not either be a right issue or a public issue. Private placement of shares or convertible securities by listed issuer can be of three types:

(i) Preferential Allotment: When a listed issuer issues shares or convertible securities, to a select group of persons in terms of provisions of Chapter V of SEBI (ICDR) Regulations, 2018, it is called a preferential allotment. The issuer is required to comply with various provisions which inter-alia include pricing, disclosures in the notice, lock-in etc., in addition to the requirements specified in the Companies Act.

(ii) Qualified Institutions Placement (QIP): When a listed issuer issues equity shares or non-convertible debt instruments along with warrants and convertible securities other than warrants to Qualified Institutions Buyers only, in terms of provisions of Chapter VI of SEBI (ICDR) Regulations, 2018, it is called a QIP.

A listed issuer may make qualified institutions placement if it satisfies the following conditions:

(a) A special resolution has to be passed by the shareholders by approving the qualified institutions placement;

(b) The equity shares of the same class, which are proposed to be allotted through qualified institutions placement or pursuant to conversion or exchange of eligible securities offered through qualified institutions placement, have been listed on a recognized stock exchange having nationwide trading terminal for a period of at least one year prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution.

(c) An issuer shall be eligible to make a qualified institutions placement if any of its promoters or directors is not a fugitive economic offender.

(d) A qualified institutions placement shall be managed by merchant banker(s) registered with the Board who shall exercise due diligence.

(e) The qualified institutions placement shall be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date.

(f) The minimum number of allottees for each placement of eligible securities made under qualified institutions placement shall not be less than:

    (i) two, where the issue size is less than or equal to two hundred and fifty crore rupees;

(ii) five, where the issue size is greater than two hundred and fifty crore rupees.

Provided that no single allottee shall be allotted more than 50% of the issue size.

(g) The tenure of the convertible or exchangeable eligible securities issued through qualified institutional placement shall not exceed sixty months from the date of allotment.

(h) The issuer shall not make any subsequent qualified institutions placement until the expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

(Source: SEBI website)

4.2 Types of Offer Documents

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

Terms used for offer documents vary depending upon the stage or type of the issue where the document is used.

The terms used for offer documents are defined below:

(i) **Draft offer document** is an offer document filed with SEBI for specifying changes, if any, in it, before it is filed with the Registrar of companies (ROCs). Draft offer document is made available in public domain including websites of SEBI, concerned stock exchanges, or concerned Merchant Banker for enabling public to give comments, if any, on the draft offer document.

(ii) **Red herring prospectus** is an offer document used in case of a book built public issue. It contains all the relevant details except that of price or number of shares being offered. It is filed with ROC before the issue opens.

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

(iv) **Letter of offer** is an offer document in case of a Rights issue of shares or convertible securities and is filed with Stock exchanges before the issue opens.

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

(vi) **Abridged letter of offer** is an abridged version of the letter of offer. It is sent to all the shareholders along with the application form.

(vii) **Shelf prospectus** is a prospectus which enables an issuer to make a series of issues within a period of 1 year without the need of filing a fresh prospectus every time. This facility is available to public sector banks, scheduled banks and Public Financial Institutions.

(viii) **Placement document** is an offer document for the purpose of Qualified Institutional Placement and contains all the relevant and material disclosures. *(Source:SEBI website)*

Key disclosure requirements of offer document

Key disclosures required to be made in an offer document i.e. in a prospectus are given as below:

(i) names and addresses of the registered office of the company, company secretary, Chief Financial Officer, auditors, legal advisers, bankers, trustees, if any, underwriters etc;

(ii) dates of the opening and closing of the issue, and declaration about the issue of allotment letters and refunds within the prescribed time;

(iii) a statement by the Board of Directors about the separate bank account where all monies received out of the issue are to be transferred and disclosure of details of all monies including utilized and unutilized monies out of the previous issue;

(iv) details about underwriting of the issue;

(v) the authority for the issue and the details of the resolution passed therefor;

(vi) procedure and time schedule for allotment and issue of securities;

(vii) capital structure of the company;

(viii) main objects of public offer and terms of the present issue;

(ix) Main objects and present business of the company and its location, schedule of implementation of the project;

(x) Particulars relating to management perception of risk factors specific to the project, gestation period of the project, extent of progress made in the project and deadlines for completion of the project;

(xi) minimum subscription, amount payable by way of premium, issue of shares otherwise than on cash;

(xii) details of directors including their appointments and remuneration,

(xiii) sources of promoter's contribution.

4.3 Issue Requirements

SEBI has laid down entry norms for entities making a public issue/ offer. The same are detailed below -

Entry Norms: Entry norms are different routes available to an issuer for accessing the capital market by way of a public issue. They are meant for protecting the investors by restricting fund raising by companies if they do not satisfy the entry requirements.

(i) An unlisted issuer making a Public Issue (i.e. IPO) is required to satisfy the following provisions:

Entry Norm I (commonly known as "Profitability Route")

The Issuer Company shall meet the following requirements:

(a) Net Tangible Assets of at least Rs. 3 crores in each of the preceding three full years of which not more than 50% are held in monetary assets. However, the limit of fifty percent on monetary assets shall not be applicable in case the public offer is made entirely through offer for sale.

(b) Minimum of Rs. 15 crores as average pre-tax operating profit in at least three of the immediately preceding five years.

(c) Net worth of at least Rs. 1 crore in each of the preceding three full years.

(d) If the company has changed its name within the last one year, at least 50% revenue for the preceding 1 year should be from the activity suggested by the new name.

To provide sufficient flexibility and also to ensure that genuine companies are not limited from fund raising on account of strict parameters, SEBI has provided the alternative route to the companies not satisfying any of the above conditions, for accessing the primary Market, as under:

Entry Norm II (Commonly known as "QIB Route")

Issue shall be through book building route, with at least 75% of net offer to the public to be mandatorily allotted to the Qualified Institutional Buyers (QIBs). The company shall refund the subscription money if the minimum subscription of QIBs is not attained.

(ii) A listed issuer making a public issue (i.e. FPO) is required to satisfy the following requirements:

(a) If the company has changed its name within the last one year, at least 50% revenue for the preceding 1 year should be from the activity suggested by the new name.

An issuer not satisfying the condition as stated above may make a further public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

Certain other general conditions to be satisfied by the issuer with regard to further public offer are given as below:

(i) It has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of Schedule XIX;

(ii) It has entered into an agreement with a depository for dematerialization of specified securities already issued and proposed to be issued;

(c) All its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

(d) It has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for the specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals. *(Source: SEBI Website)*

However, there are no entry norms for a listed company making a right issue.

4.4 Mandatory provisions to be complied with before making a public issue

An issuer making a public issue is required to inter-alia comply with the following provisions:

(i) Minimum Promoter's contribution and lock-in: In a public issue by an unlisted issuer, the promoters shall contribute not less than 20% of the proposed issue size or to the extent of 20 % of the post issue capital which should be locked in for a period of 3 years. "Lock-in" indicates a freeze on the shares. In case of a composite issue (i.e. further public offer cum rights issue), minimum promoter's contribution is either to the extent of twenty per cent of the proposed issue size or to the extent of twenty per cent of the post issue capital excluding the rights issue component. In cases where the promoters contribution has been brought in and utilized, then a cash flow statement disclosing the use of funds in the offer document should be included. This provision ensures that promoters of the company have some minimum stake in the company for a minimum period after the issue or after the project for which funds have been raised from the public is commenced.

(ii) IPO Grading: IPO Grading is the credit rating granted by a credit rating agency to the Initial Public Offer of a company. Such a credit rating agency shall be registered with SEBI. Such a grading granted to the IPO of a company takes into account the relative assessment of fundamentals of an IPO. In comparison to other listed equity shares, the IPO Grading so obtained has to be disclosed mandatorily by the companies going for an IPO.

The IPO Grading is generally granted on a five point scale with a higher scale indicates stronger fundamentals and vice versa. This has been shown as below:

IPO grade 1 - Poor fundamentals

IPO grade 2 - Below-Average fundamentals

IPO grade 3 - Average fundamentals

IPO grade 4 - Above-average fundamentals

IPO grade 5 - Strong fundamentals

The purpose of IPO Grading is to make available additional information to the investors. This will help them to assess the fundamentals of a company more judiciously.

The IPO Grading can be done either before filing the offer document with SEBI or later on. However, the prospectus/RHP must highlight the grades given to IPO's by the Credit Rating Agencies. Further, the companies coming out with an IPO are required to bear the expenses required for grading an IPO.

However, it is noted that w.e.f. February 4, 2014, IPO Grading has been made optional.

The IPO grading process takes into account the following points:

(i) Prospects of the industry in which the company operates.

(ii) Competitive strengths of the company

(iii) Company's financial position.

To arrive at an IPO Grade, following aspects are looked into by the rating agencies. However, the list is not exhaustive and may vary.

a. Business Prospects and Competitive Position (i. Industry Prospects ii. Company Prospects)

b. Financial Position

c. Management Quality

d. Corporate Governance Practices

e. Compliance and Litigation History

f. New Projects—Risks and Prospects

It can be reiterated that the above lists may vary on case to case basis. Further, IPO Grading does not take into account the price at which the shares are to be issued to the public. So, the investors have to make an independent judgement regarding the price at which shares are to be bid during the IPO process.

Therefore, it can be said that though the objective of a credit rating agency is to give an opinion about an IPO, the investors are also required to take safeguards by studying the prospectus including risk factors very carefully by making an independent judgement.

Further, it is to be noted that SEBI does not play any role in the grading process of the CRA. The grading is entirely an independent and unbiased opinion of CRA. Therefore, SEBI's opinion of the IPO document is entirely independent of the opinions expressed or grades given by CRAs.

4.5 Pricing of an Issue

Before 1992, pricing of the issue was decided by the Controller of Capital Issues (CCI) under the Capital Issues (Control) Act, 1947. In 1992, the Capital Issues (Control) Act, 1947 was repealed.

And, then, the public issues came out of the shackles of CCI. Pricing of Issues can be freely arrived at by the companies in consultation with the Merchant Banker.

The offer document discloses the parameters on the basis of which the price is arrived at. These are EPS, PE multiple, return on net worth etc. The parameters as stated above are also compared with the peer group companies.

The public issue can be segregated into either a fixed price issue or a book built issue. If the price is already mentioned in the offer document, it is called a fixed price issue. Conversely, when the price is discovered on the basis of demand received from the investors at different levels of price, it is called a 'Book Built Issue'.

The price is disclosed in the fixed price issue in the draft prospectus. And, the floor price or price band in the case of a book built issue is disclosed in the Red Herring Prospectus. Where the issuer opts not to make the disclosure of the floor price or price band in the red herring prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of Schedule X.

4.6 Intermediaries to the Capital Market

1. **Merchant Bankers/Lead Managers –** Merchant Banker/Lead Manager actually manages the issue. He makes the entire management regarding purchase and sale of securities. He also provides corporate advisory services in relation to issue management. Pre issue and post issue due diligence of the public issue is also handled by the Merchant Banker.

2. **Underwriters –** The IPO underwriters generally hire specialists in their staff. The underwriters who are generally investment banks have to ensure that all the regulatory requirements are complied with.

Secondly, the investment banker pursues the large institutional investors such as mutual funds, pension funds and insurance companies to invest in the company. The amount of interest generated by these large institutional investors into the company's shares helps the underwriter to set the price of IPO of the company's stock.

3. **Bankers to an Issue** – They are scheduled banks who carry any one or more of the following activities:

(i) acceptance of application and application monies;

(ii) acceptance of allotment or call monies;

(iii) refund of application monies;

(iv) payment of dividend or interest warrants.

4. **Brokers to an issue –** the brokers to an issue acts as an agent to the investor. He charges commission for the services rendered by him. So, the task of brokers is to execute buy or sell orders.

5. **Debenture Trustees** – As per SEBI Regulations, "Debenture Trustee" means a trustee appointed in respect of any issue of debentures of a body corporate. They should either be a schedule commercial bank, a public financial institution, an insurance company or a body corporate. It is also required to be registered with SEBI.

6. **Registrars to Issue** – According to SEBI Regulations, "Registrar to an Issue" means the person appointed by a body corporate or any person or group of persons to carry on the following:

(i) collecting applications from investors in respect of an issue;

(ii) keeping a proper record of applications and monies received from investors or paid to the seller of the securities and

(iii) assisting body corporate or person or group of persons in-

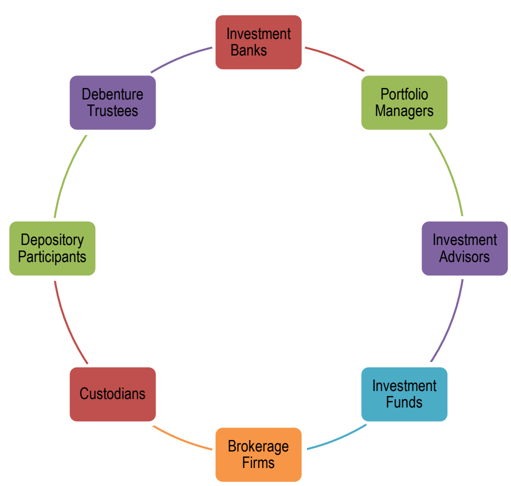
  (a) determining the basis of allotment of securities in consultation with the stock exchange;

  (b) finalizing of the list of persons entitled to allotment of securities;

  (c) processing and dispatching allotment letters, refund orders or certificates and other related documents in respect of the issue.

7. **Portfolio Managers** – The job of a portfolio manager is to invest in a mutual fund, exchange traded fund or any suitable investments in securities. Further, they help their clients in developing an investment strategy, implementing the strategy developed, and manage day to day portfolio trading.

Capital Market Intermediaries



4.7 Steps involved in public issue

The various steps involved in public issue of shares are enumerated below:

1. **Board Meeting and Passing a Board Resolution for Public Issue**: Before initiating the process of public issue, a company is required to call a Board meeting and pass a Board Resolution for raising the money through Public Issue.

2. **Holding of General Meeting**: If it is required by the Articles of Association, that consent of shareholder has to be obtained. For this purpose, meeting of the shareholders will be called.

3. **Appointment of Merchant Banker and other intermediaries and entering into MOU with them:** To initiate the process, the Company has to pass a Board Resolution and proceed to appoint a Merchant Banker, with whom an MOU may be entered into. It is also necessary to appoint various intermediaries i.e. underwriters, Bankers to the Issue, Registrars, and brokers to the issue for marketing the same and to enter into an agreement with them.

4. **Preparation of Draft Prospectus and its approval by Board:** A draft Prospectus has to be prepared and approved by the Board. Apart from the notice of offer to issue shares to public, prospectus should also disclose:

(a) Justification of Premium, if called

(b) Net Asset value (NAV)

(c) High and Low price of the shares of the company for the last two years

(d) Highlights of the issue, as well as the "Risk Factors"

(e) A clause that company shall refund the entire application money if minimum subscription is not received

(f) A statement by the lead managers that in their opinion the assets of the underwriters are adequate to meet their obligations

5. **Filing of prospectus with the SEBI/Registrar of Companies**: The draft prospectus along with the copies of the agreements entered into with the Lead Manager, Underwriters, Bankers, registrars and Brokers to the issue has to be filed with SEBI and the Registrar of Companies of the state where the registered office of the company is located, along with the fees & other prescribed requirements, (with due diligence by merchant banker).

6. **Intimation to Stock Exchange:** A copy of the Memorandum and Articles of Association of the company has to be sent to the Stock Exchanges where the shares are to be listed, for approval.

7. **Finalization of collection centers:** The lead manager finalizes the collection centers so that prospective investor can collect the application forms alongwith prospectus.

8. **Printing and Distribution of Prospectus and Application Forms**: After Receipt of Acknowledgement card from the SEBI and the intimation from Registrar of Companies regarding

registration of prospectus, the company should take steps to issue the prospectus within 90 days of its registration with ROC.

9. Announcement and Advertisement: Announcement regarding the proposed issue should be made at least ten days before the subscription list opens. No advertisement should include Brand Names for the issue except the normal commercial name of the company or commercial brand names of the company or commercial brand names of its products already in use.

10. Subscription List: As stipulated by SEBI Regulations, the subscription list for public issue is to be kept open for at least 3 working days and for a total period not exceeding 10 working days, which is to be disclosed in prospectus as well. In case of a book built issue, bid is open for a maximum period of 7 working days which can be extended by 3 days in case of revision in price band.

11. Separate Bank Account: A separate bank account is opened for the purpose of collecting the proceeds of the issue. Further, the date of opening and closing of the subscription list should be intimated to all the collecting and controlling branches of the bank with whom the company has entered into an agreement for the collection of application forms.

12. Minimum Subscription: Section 39 of the Companies Act, 2013 prohibits allotment of securities where the minimum amount as stated in the prospectus has not been subscribed. If the stated minimum amount has not been subscribed and the sum payable on application is not received within the period specified therein, then the application money shall be repaid within a period of fifteen days from the closure of the issue, and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally liable to repay that money with interest at the rate of fifteen percent per annum.

13. Promoters' contribution: A certificate to the effect that the required contribution of the promoters has been raised before opening the issue, has to be obtained from a Chartered Accountant, and duly filed with SEBI.

14. Allotment of Shares: A return of allotment in the prescribed form as given under the Companies Act, 2013 should be filed with Registrar of companies within 30 days of the date of allotment along with the prescribed fees. In case, the issue is oversubscribed, the basis of allotment has to be decided in consultation with the stock exchange authorities as per the guidelines laid down by the stock exchanges.

15. Compliance Report: As stipulated by SEBI guidelines, within 45 days of the closure of issue, a report in the prescribed form along with a compliance certificate from statutory auditor/ practicing chartered accountant or by a company secretary in practice has to be forwarded to SEBI by the lead managers.

16. Issuance of Share Certificates: As per provisions of the Companies Act, 2013, the company should deliver the share certificates within 2 months from the date of allotment of shares.

4.8 Public Issue of Shares - Book Building Route

Book Building is a process undertaken to assess a demand for the securities proposed to be issued by a corporate body is elicited and built up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement, document or information memoranda or offer document.

In book building process, the price at which securities will be issued to the public is not known while in case of offer of shares through normal public issue, price is known in advance to investor. In case of Book Building, the demand can be known everyday as the book is built. But in case of the public issue, the demand is known at the close of the issue. The Book should remain open for a minimum of 3 working days.

Book Building Method

Book building is a method of price discovery. In this method, offer price of securities is determined on the basis of real demand for the shares at various price levels in the market. "Book building" means a process undertaken to elicit demand and to assess the price for determination of the quantum or value of specified securities or Indian Depository Receipts, as the case may be, in accordance with SEBI (ICDR) regulations;

In book building method, the final issue price is not known in advance. Only a price band is determined and made public before opening of the bidding process. The spread of price between floor price and cap in the price band should not be more than 20%. It means that the cap should not be more than 120% of the floor price. Issuing Company appoints a merchant banker as Book Runner Lead Manager (BRLM), who may be assisted by other co- managers and by a team of syndicate members acting as underwriters to the issue.

The BRLM sends copies of Red Herring Prospectus to the Qualified Institutional Buyers (QIBs), large Investors, SEBI registered Foreign Institutional Investors (FIIs) and to the syndicate members. BRLM also appoints brokers of the stock exchanges, called bidding centres. They accept the bids and application forms from the investors. These bidding centres place the order of bidders with the company through BRLM. They are liable for any default, if any, made by their clients, who have applied through them. Brokers/ Syndicate members collect money from clients/ investors. Money received by them at the time of accepting bids is called margin money. Bids can be made through on-line and transparent system of National Stock Exchange and Bombay Stock Exchange depending upon the agreement of the issuer with the stock exchange(s).

A public issue shall be kept open for three working days but not more than ten working days. An issue through book building system remains open for three to seven working days. In case of revision of price band, the issue period disclosed in the red herring prospectus can be extended for a minimum period of three working days. However, the total bidding period shall not exceed ten working days. In other words, in case of a book built issue, bid is open for a minimum period of three working days and maximum period of seven working days, which may be extended to a maximum of ten working days, in case the price band is revised.

Difference between fixed price method and Book Building methods of the pricing of public issue.

(a) In Fixed price method, Price at which the securities are offered and would be allotted is made known in advance to the investors while in book building method, a 20 % price band is offered by the issuer within which investors are allowed to bid and the final price is determined by the issuer only after closure of the bidding.

(b) In Fixed Price method, Demand for the securities offered is known only after the closure of the issue while in book building method Demand for the securities offered, and at various prices, is available on a real time basis on the BSE website during the bidding period.

(c) In fixed price method, 100% advance payment is required to be made by the investors at the time of application, while in book building method, 10 % advance payment is required to be made by the QIBs along with the application, while other categories of investors have to pay 100% advance along with the application.

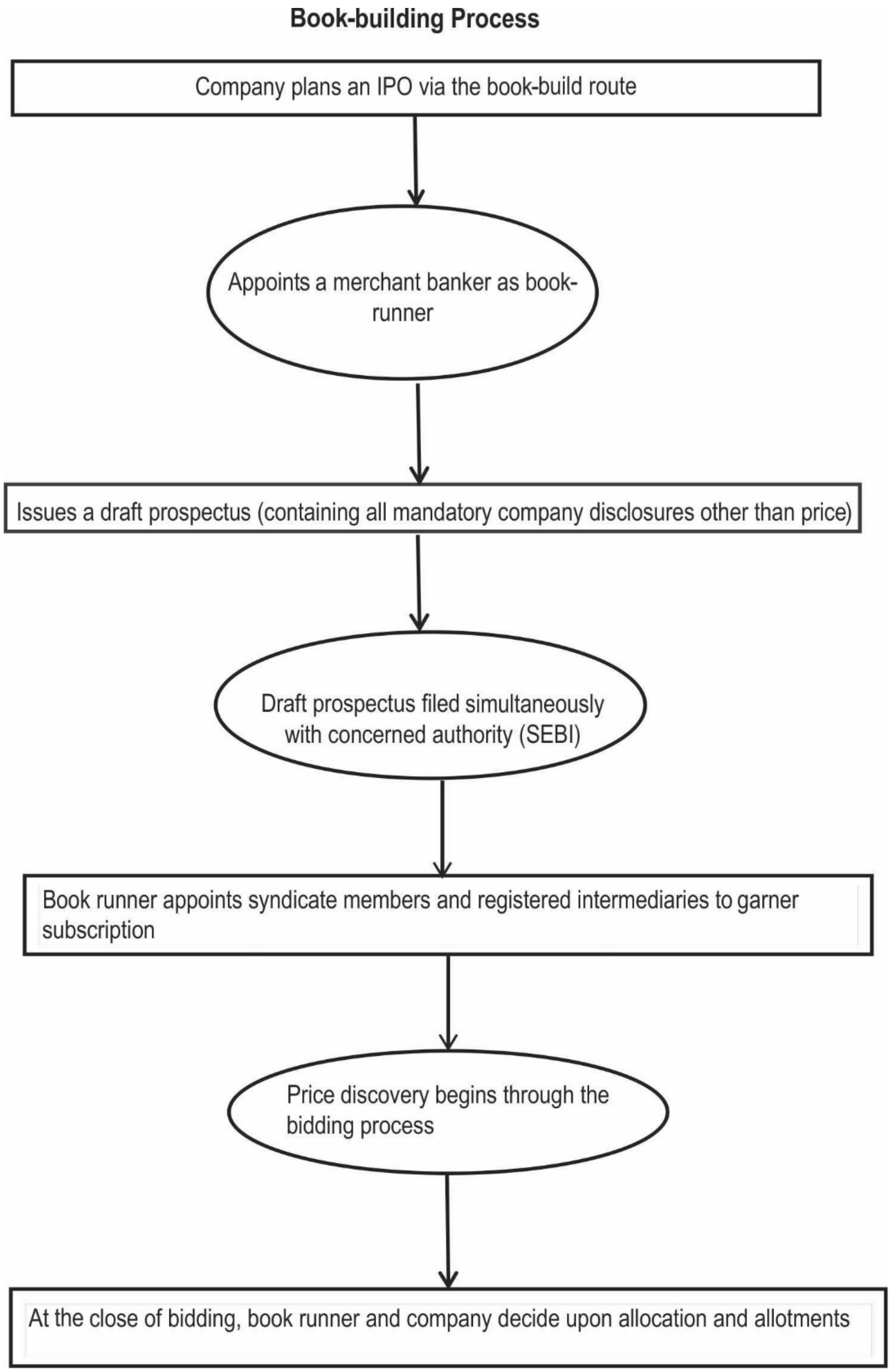
Price discovery under book building process

Suppose a company comes with the public offer of 3,000 shares. The company chooses the book building process for price discovery and decides the price band of Rs. 20 – 24. The company received the bidding as depicted in the table given below:

Bid Quantity	Bid Price	Cumulative Quantity	Subscription
500	24	500	16.67%
1,000	23	1,500	50.00%
1,500	22	3,000	100.00%
2,000	21	5,000	166.67%
2,500	20	7,500	250.00%

Now, on the basis of the above table, the company would obviously want to sell all the shares at the highest price of Rs. 24, but at this price, it would be able to sell only 500 shares and at Rs. 23, it would be able to sell only 1500 shares only. In order to sell all 3000 shares it has issued to the public, the company would have to further lower the price by Rs. 1. It means that the company has received 3,000 bids from people interested in buying the stock at Rs. 22. In this case, Rs. 22 becomes the cut – off price. Now the company will price the IPO at 22 or lower, but not at a higher price since it didn't receive enough bids to be able to get offering fully subscribed. This is known as the price discovery mechanism of the book building process, and the way most IPOs are priced these days.

The Flowchart given as follows explains the book building process



Some interesting facts about the book building process

(i) The issuer may mention the floor price or price band in the red herring prospectus.

(a) If the issuer chooses not to disclose price band or floor price in the red herring prospectus, the price band or the floor price shall be disclosed at least two working days in the case of initial public offer and at least one working day in the case of further public offer before the opening of the bid.

(b) Where the issuer opts for price band instead of floor price, it shall ensure that spread between floor and cap of the price band should not be more than 20 percent. This price band denotes the range of bidding.

(ii) In case of a composite issue, price of a public issue may be different from the price offered in right issue. However, justification for such price difference shall be provided in the offer document.

(iii) The bidding terminal shall contain on-line graphical display of demand and bid prices updated at periodical intervals, not exceeding thirty minutes.

(iv) At the end of each day of the bidding period, the demand including allocation made to anchor investors shall be shown graphically in the bidding terminals of syndicate members and websites of recognized stock exchanges offering electronically linked transparent bidding facility, for information of public.

(v) The investors except ASBA investors may revise their bids.

(vi) The issuer in consultation with the book running lead manager determines the issue price on the bid received.

(vii) On the determination of the price, the number of securities to be offered shall be decided.

(viii) Once the final price is determined, those bidders whose bids have been successful (bid at or above the final price), shall be entitled for allotment of securities.

4.9 Applications Supported by Blocked Amount (ASBA)

It is an alternate payment system for book built issue launched by SEBI in August 2008. Initially, ASBA was mandatory for public issues going through the book building route. And,it was optional for other public issues.But now, Payment through ASBA i.e. Application Supported by Blocked Amount has been made mandatory by SEBI for applying to any public issue of equity shares from January 1st, 2016.

ASBA is basically an application by investors for subscribing to an issue containing an authorization to block the application money in a bank account.

An alternative payment mode for applying in primary issues, ASBA has helped investors do away with getting Demand Drafts or Cheques made for payment of application money. Therefore, one's money stays in one's bank account until allotment of the issue takes place.There is no hassle of refunds - in case of less or no allotment of shares. The advantage is that one get to earn interest even on the blocked amount until it is debited for allotment.

Vadodara-based 20 Microns Ltd was the first company to come out with an initial public offer (IPO) through the new Securities and Exchange Board of India (SEBI) guidelines of Applications Supported by Blocked Amount (ASBA) in September,2008.

The process of ASBA has been explained with the help of an example:

(i) An ASBA investor shall submit an application to the Self-certified Syndicate Bank (SCSB) with whom the bank account to be blocked is to be maintained.

(ii) The SCSB will then block the application money in the bank account specified in the ASBA. The application money will remain blocked in the bank account till the allotment of securities or till the withdrawal/failure of the issue or till withdrawal or rejection of the application.

(iii) The SCSB shall upload the details in the electronic bidding system of the BSE or NSE.

(iv) After the basis of allotment is finalized, the Registrar to an Issue shall send a request to the SCSB for unblocking the bank account and transferring the allotment money to the issuers escrow account. In case of withdrawal of issue, the bank account shall be unblocked on the information received from pre issue merchant bankers.

4.10 What is a Green Shoe Option?

It is an overallotment mechanism. Green Shoe Option is an option to allocate shares in excess of the shares which have already been issued to the public. It is a price stability mechanism to provide post listing price stability to an initial public offering.

The process of Green Shoe Option can be explained with the help of following example:

1. If a company is issuing 100000 shares, the company will enter into an agreement regarding overallotment option (green shoe option) with one of the stabilizing agents (mostly underwriters) to the extent of 15000 shares (maximum of 15% of the issue size).

2. According to the agreement, the promoters would lend 15000 shares to the stabilizing agents for a limited period of 30 days from the date of listing.

3. Allotment would be made to the extent of 1,15,000 shares (100000 shares issued by the company and 15000 shares borrowed from the promoters.

4. On listing, if the market price falls below the issue price, the stabilizing agent may buy shares from the market to the extent of 15000 shares. This may help to increase the market price of shares by reducing the selling pressure. The shares purchased by the stabilizing agent are then returned to the promoters. So, only 100000 shares remain listed on the stock exchange after 30 days.

5. However, on listing, if the share prices rises, and the stabilizing agent doesn't buy shares from the market, then at the end of 30 days period, the over allotment option is exercised.

The company allots 15000 more shares which are then returned to the promoters. Thus, 1,15,000 shares remain listed on the exchange.

Thus, Green Shoe Option acts as a price stabilizing mechanism. Further, over-allotment options are known as Green Shoe options because, in 1919, Green Shoe Manufacturing Company (now part of Wolverine World Wide Inc.), was the first to issue this type of option. A Green Shoe option can provide additional price stability to a security issue because the underwriter has the ability to increase supply and smooth out price fluctuations. It is the only type of price stabilization measure permitted by the Securities and Exchange Commission (SEC) in USA.

Simply put, it is a price stabilization mechanism whereby a company over-allots shares to investors participating in the issue, with a view to have the merchant banker buy them back from the open market after listing, in order to arrest any fall in the share prices below the issue price. SEBI introduced the Green Shoe mechanism in Indian capital markets in 2003 vide a circular SEBI/ CFD/DIL/ DIP/Circular No. 11 dated 14th August, 2003. Since then, a number of companies have implemented the Green Shoe Option in their initial public offerings.

Illustration 1

ABC Ltd. issued 15 lakh shares of Rs 100 each. Green shoe option was exercised by the company prior to the issue. After listing, the share prices of ABC Ltd. plunged to Rs. 90. Stabilizing agents decided to buy shares from the market. How many shares can be purchased by the stabilizing agents to arrest the reduction in share prices?

Solution

Here, in the above illustration, Green Shoe Option was exercised. Therefore, the stabilizing agents can purchase upto a maximum of 225000 shares i.e. 1500000 x 15/100.

4.11 Anchor Investors

Who is an anchor investor?

Anchor investors are Qualified Institutional Buyers (QIB) who purchases shares one day before the IPO opens. They help in arriving at a fair price and instill confidence in the minds of the investors. As the name suggests, they are supposed to 'anchor' the issue by agreeing to subscribe to shares at a fixed price so that other investors may know that there is demand for the shares offered. SEBI introduced the concept of anchor investors in June, 2009 to enhance issuing company's ability to sell the issue. The Adani Power IPO in July 2009 was the first issue in the country to attract investors under the anchor investor scheme.

Why anchor investors are important?

Today, many companies have a complex structure and are not necessarily profitable at the net level — Sadhbhav Infrastructure Projects, Adlabs Entertainment and Café Coffee Day are examples. In such cases, the anchor investors can guide other investors.

Unlike analysts, brokerages or investment bankers who may put out reports on an IPO, anchor investors have their own skin in game. They have actually subscribed to the shares at the published price. As the anchor portion of an issue is usually taken up by serious institutions such as mutual funds, insurance companies and foreign funds, their valuation signals can be useful. If the issue has problems, say, of corporate governance, or asks for a stiff price, the issue will face a tepid response from anchor investors.

For example - Prabhat Dairy's offer failed to draw anchor investors as the price was at a sizeable premium to listed peers and there were challenges in growing the business. In the case of Adlabs Entertainment IPO too, anchor investors had bid at the lower end of the price band. In the public issue which opened a day later, poor retail response forced the company to lower its price band to get subscribed. *(Source: Business Line)*

Guidelines for Anchor Investors

The following guidelines have to be complied with to bring in anchor investors in public issue:

1. An anchor investor shall make an application of a value of at least Rs. 10 crore in the public issue.
2. An issuer can now allot up to 60% of shares reserved for qualified institutional buyers (QIBs) to anchor investors. So, the QIB portion in an IPO is 50%, anchor investors can buy up to 30% of an IPO.
3. One-third of the anchor investor portion shall be reserved for domestic mutual fund.
4. The bidding for anchor investors shall open one day before the issue opens.
5. Anchor investors shall pay at least 25% margin money on application. Balance has to be paid within two days of the date of closure of the issue.
6. Allocation of shares to anchor investors shall be completed on the day of bidding itself.
7. If the price arrived at after the book building issue is higher than the price at which shares were allocated to anchor investors, then in that situation, the anchor investor shall bring in the additional amount. But, if the price arrived at after the book building process is lower than the price at which shares were allocated to anchor investors, the excess amount shall be refunded to the anchor investors.
8. Anchor investors, however, cannot sell their shares for a period of 30 days from the date of allotment as against IPO investors who are allowed to sell on listing day.
9. Lastly, the merchant bankers or any person related to the promoter/promoter group/merchant bankers in the concerned public issue cannot apply under the anchor investor category.

Case Study of InterGlobe Aviation Ltd (Indigo Airlines) regarding Anchor Investors

InterGlobe Aviation Ltd, owner of India's most profitable airline IndiGo, received demand for around eight times the shares it offered to so-called anchor investors, including domestic and foreign institutions, a day before the start of its initial public offering (IPO).

The company raised Rs.832 crore via the anchor investor allocation, also known as the anchor book, selling shares at Rs.765 per share at the upper end of the Rs.700-765 price band.

The company intended to use the proceeds of the fresh issue of shares primarily to retire its aircraft lease obligations. It utilized Rs 1165.66 crore to retire some of the exiting aircraft lease obligations. The company will utilize Rs 34.25 crore for purchase of ground support equipment for its airline operations and the remaining amount for general corporate purposes.

The anchor investors include among others Harvard University Endowment Fund, Goldman Sachs Group Inc., Ruane Cunniff & Goldfarb Inc., Fidelity Investments, Black Rock Inc., Dutch pension fund APG and GIC Pte. Ltd,and Singapore's sovereign wealth fund. Domestic investors include HDFC Mutual Fund and Sundaram Mutual Fund.

The IPO of Inter Globe Aviation Ltd is one of the largest anchor books for an Indian IPO and over 40 investors have subscribed to it. The demand for the main IPO book was very strong before the issue date and given the names of the anchor investors, retail investors have also attracted to the issue.

Inter Globe is seeking to raise ₹ 3,000 crore from the IPO, including the anchor book. IndiGo had total debt of ₹ 3,912 crore as of 31 August, all of which was aircraft-related. The company intended to use the proceeds of the fresh issue of shares primarily to reduce its aircraft lease obligations. It utilized ₹ 1165.66 crore to pay some of the exiting aircraft lease obligations. The company will utilize ₹ 34.25 crore for purchase of ground support equipment for its airline operations and the remaining amount for general corporate purposes.

(Adapted from Business Standard and Livemint)

4.12 Private Placement of Shares

Private placement is the process of raising capital directly from institutional investors. A company that does not have access to or does not wish to make use of public capital markets can issue stocks, bonds, or other financial instruments directly to institutional investors. Institutional investors include mutual funds, pension funds, insurance companies, and large banks.

Private placement means any offer of securities or invitation to subscribe securities to a select group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section 42 of the Companies Act, 2013.

The proposed offer of securities or invitation to subscribe securities needs to be approved by the shareholders of the Company by way of a Special Resolution, for each of the Offers/Invitations.

Advantages of Private Placement

The primary advantage of the private placement is that it bypasses the stringent regulatory requirements of a public offering. Public offerings must be done in accordance with the Companies Act, 2013 and regulations made thereunder. Private placements are negotiated privately between the investors and the issuing company.

Another advantage of private placement is the reduction in the time of issuance and the cost of issuance. Issuing securities publicly can be time-consuming and may require certain expenses. A private placement foregoes the time and costs that come with a public offering.

Also, because private placements are negotiated privately between the investors and the issuing company, they can be tailored to meet the financing needs of the company and the investing needs of the investor. This gives both parties a degree of flexibility.

Why private placements of shares are frequently resorted to by the companies?

Private Placement of shares offers many advantages. Primary advantage of the private placement is that it bypasses the stringent regulatory requirements of a public offering. Public offerings must be done in accordance with SEBI regulations. Private placements are negotiated privately between the investors and the issuing company. For Private placements, the companies need to comply with the companies Act, 2013 provisions but they do not have to register with the SEBI.

Another advantage of private placement is the reduced time of issuance and the reduced costs of issuance. Issuing securities publicly can be time-consuming and may require certain expenses. A private placement forgoes the time and costs that come with a public offering.

Also, because private placements are negotiated privately between the investors and the issuing company, they can be tailored to meet the financing needs of the company and the investing needs of the investor. This gives both parties a degree of flexibility.

Case Study on Private Placement

Springer Limited is a US based company and is a famous manufacturer of electric appliances. The Board of Directors of Springer Company decided to expand the company market area and decided to enter new markets such as India and other south Asian countries and Latin American countries. The company decided to incorporate a company in India named Springer India Limited. Springer India Limited decided to raise money from Indian market. The company has two options i.e. to raise money through private placement of shares or to raise money from public issue.

Evaluate the two options available to company and give your report containing the comparative of advantages and disadvantages of both options so as to enable company to take appropriate decision.

Answer to the question raised above on the Case Study on Private Placement

Questions raised in the case study on private placement have been answered in the following points:-

(i) **Meaning of Public Issue:** The sale of equity shares or other financial instruments by an organization to the public in order to raise funds is called public issue. Any offer to more than 200 people in India is termed as public offer. In India, Public offer is governed by Securities and Exchange Board of India (SEBI).

(ii) **Meaning of Private Placement of Shares:** When a company issues financial securities such as shares and convertible securities to a particular group of investors (not more than 200 persons in a financial year), it is known as private placement.

Any offer of securities or invitation to a selected group of persons by a company (other than by way of public offer) through issue of a private placement offer letter and which satisfies the conditions specified in section-42 of the Companies Act, 2013.

(iii) **Advantages of Public Offerings:** One of the major advantages of a public offering is that it allows a company to raise a large amount of money. This is because anyone who can afford to invest can purchase the company's stock through a broker. Moreover, the shares in the company will be highly liquid. For the same reason, there will always be buyers and sellers in the market. There is prestige in an IPO, and it can bring wide exposure and a great deal of information about a company to the forefront.

(iv) **Disadvantages:** When it comes to a public offering, such as an IPO, a potential disadvantage is time. The public offer process is very time consuming and it takes a lot of time. Public offer calls for tough compliances of stock exchange regulations (prescribed by SEBI) on a continuous basis.

(v) **Advantages of Private Placements:** A private placement will probably be cheaper and faster. Public companies must fulfill strict reporting and registration requirements, while companies that sell equity through a private placement face fewer reporting requirements. With a private placement, it might be easier to decide to whom owners sell equity, and to keep certain information about the company a secret.

(vi) **Disadvantages of Private Placement:** One disadvantage of a private placement as against public offering is that it significantly narrows the range of investors, the company may reach. Since the number of investors is not large, it becomes difficult for the company to arrange large funds as each investor will probably be required to have comparatively more capital to invest in the company.

4.13 Disinvestment

It means sale of equity shares of PSU's which leads to dilution of govt.'s shares in such PSU's. The disinvestment programme was initiated by the Govt. of India in 1992-94.

The purpose of the disinvestment programme of the Govt. of India was to garner funds which can be utilized for development purpose. Another purpose was to make the loss making PSUs came out of the doldrums and contribute to the Indian economy.

The primary objectives of the disinvestment programme of the Govt. of India are enumerated as below:

(i) To raise funds to finance fiscal deficit.

(ii) At the same time, to retain control over management.

(iii) And, improve the management of the PSU.

(iv) To broad base equity.

(v) To increase the availability of resources for PSUs.

4.14 Right Issue

The rights issue involves selling of securities to the existing shareholders in addition to their current holding. As per section 62 of the Companies Act, 2013, where, at any time, a company having a share capital, proposes to increase its Subscribed Capital by the issue of further shares, such shares shall be offered to persons who, on the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:-

(i) The offer shall be made by a notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

(ii) Unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (above) shall contain a statement of this right;

(iii) After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose them off in such manner which is not dis-advantageous to the shareholders and the company.

(iv) The notice referred to above shall be dispatched through registered post or speed post or through electronic mode to the entire existing shareholders at least three days before the opening of the issue.

Procedure for allotment of right issue of shares

1. Call a Board meeting by issue notice of meeting and approve right issue including “letter of offer”, which shall include right of renunciation also.

2. Send offer letter to all existing members as on the date of offer through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.

3. Receive acceptance/renunciations/rejection of rights from members to whom offer has been sent & also from persons in whose favour right has been renounced.

4. Call a Board meeting by issue of notice. Approve allotment by passing a Board Resolution.

5. Attach list of allottees in form PAS-3, mentioning Name, Address, occupation, if any, and number of securities allotted to each of the allottees and the list shall be certified by the signatory of the form PAS - 3.

6. File E-form MGT 14 for issue of Share (Allotment of shares & Issue of Share Certificate) & PAS 3 (Return of Allotment) to ROC for allotment.

7. Make Allotment within 60 days of receiving of Application Money, otherwise it will be treated as deposits as per deposit rules.

4.15 Exit Offers (Delisting Offers and Strategic Issues)

With reference to capital market, the term 'exit offers' refers to delisting. So here we would be explaining the term delisting and provision/issues relating to delisting.

Delisting is actually the reverse of listing. So, what is the meaning of the term listing? Listing is basically a platform provided to the newly issued securities of the company in which sale and purchase of the securities of a company takes place. On the other hand, delisting means to permanently remove the securities of a listed company from a stock exchange.

Delisting of companies signifies a listed company moving out of the listing status on the stock exchanges. Broadly, delisting falls under two categories. One is voluntary delisting by the promoters of the company on a voluntary basis. There is no regulatory compulsion under any statutory provisions to initiate delisting. The second category is mandatory delisting, which gets triggered due to some regulatory compulsion under statutory provisions.

Delisting in India capital market is governed by the SEBI (Delisting of Equity Shares) Regulations, 2009. These Regulations provide three different sets of provisions for delisting of equity shares under different circumstances.

1. 'Voluntary delisting' means delisting of equity shares of a company voluntarily on application of the company under these regulations. The main delisting provision pertains to the voluntary delisting sought by the promoters of a company from the only recognized stock exchange giving exit opportunity to all public shareholders.

2. 'Compulsory delisting' means delisting of equity shares of a company by a recognized Stock exchange on any ground prescribed in the rules made under section 21A of the Securities Contracts (Regulation) Act, 1956.

3. Special provision for delisting of small companies not frequently traded or with small number of shareholders.

These regulations are applicable to delisting of equity shares of a company from all or any of the recognized stock exchanges where such shares are listed. However these does not apply to any delisting made pursuant to a scheme sanctioned by the Board for Industrial and Financial Reconstruction under the SICA or by the NCLT under the Companies Act, 2013, if such scheme specify procedure to complete the delisting; or provides an exit option to the existing public shareholders at a specified rate.

According to the SEBI Delisting Regulations, a company cannot apply for delisting of its equity shares pursuant to Buy back of its equity shares, or preferential allotment made by the company. A company cannot go for delisting unless a period of three years has elapsed since the listing of that class of equity shares on any recognized stock exchange; or if any instruments issued by the company, which are convertible into the same class of equity shares that are sought to be delisted, are outstanding. No delisting of Convertible securities may be done.

Also, the above regulations further emphasize that if after the proposed delisting from a recognized stock exchange, the equity shares would remain listed on any recognized stock exchange which has nationwide trading terminals, no exit opportunity needs to be given to the public shareholders.

CHAPTER 4

CAPITAL MARKET - SECONDARY

LEARNING OUTCOMES

After going through the chapter student shall be able to understand :

- Introduction to Secondary Market
- Development of the stock market in India
- Stock market Organization in India
- Demutualization of Stock Exchanges
- Share Trading in Secondary Market
- Stock Market and Its Operations
- Risk Management in Secondary Market
  - (1) Trading Rules and Regulations
  - (2) Circuit Breakers
  - (3) Trading and Settlement
  - (4) National Securities Clearing Corporation Limited
  - (5) Market Making System
  - (6) Securities Lending and Borrowing
  - (7) Straight Through Processing
  - (8) Margin Trading
  - (9) Short Selling
- Indian Debt Market

1. INTRODUCTION TO SECONDARY MARKET

Secondary market is a market where shares initially issued are traded. Trading of securities takes place when securities are purchased or sold. This market is also known as stock market. In India, secondary market consists of recognized stock exchanges operating under rules, regulations and guidelines approved by the government. The stock exchanges are organized market where securities issued by the Companies, Central and State Government, and public bodies are traded. As per section 2(j) of the Securities Contract Regulation Act, 1956, "stock exchange" means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

Therefore, in nutshell, securities issued by a company for the first time are offered to the public in the primary market. Once the IPO is done and the stock is listed, they are traded in the secondary market. The main difference between the two is that in the primary market, an investor gets securities directly from the company through IPOs, while in the secondary market, one purchase securities from other investors willing to sell the same.

Equity shares, bonds, preference shares, debentures, etc. are some of the key products available in a secondary market.

Functions of Secondary Market

(i) Economic Indicator –Every major change in the economy either due to government policy or any major international event has a bearing on the secondary/stock market. So, if the stock market is doing well, it is an indicator that economy is more or less in a stable position.

(ii) Valuation of Securities –Secondary market helps in the valuation of securities through its demand and supply. The securities of those companies which are growth oriented and doing well will surely have higher demand in comparison to securities of companies which are not doing well. Consequently, the share prices of growth oriented companies will be high.

(iii) Transaction in securities is safe in the secondary market –Transactions executed in the secondary market are safe because all the trading taking place in an electronic system which is highly secure.

(iv) Contributes to economic growth –It contributes to economic growth through allocation of funds to the most efficient sector through the process of disinvestment to reinvestment. This leads to capital formation and economic growth.

(v) Motivating people to invest in equity shares–Efficient secondary market motivate people to invest in the securities market. The reason is that the people would be less apprehensive about the riskiness of the stock market.

(vi) It ensures safety and measure of fair dealing to protect investor' interest.

(vii) It induces companies to improve their performance since market price of shares showing at the stock exchanges is the indicator that reflects a company's performance and is easily available to the investors.

2. DEVELOPMENT OF THE STOCK MARKET IN INDIA

The stock market originated in India at the end of the eighteenth century when lots of new negotiable instruments were introduced. However, the real beginning was made in the middle of nineteenth century when Companies Act, 1860 was enacted where the concept of limited liability was introduced.

The Bombay Stock Exchange was formed in 1875. This was followed by formation of exchanges in Ahmedabad in 1894, Calcutta (Kolkata) in 1908, and Madras (now Chennai) in 1937. Calcutta Stock Exchange (CSE) was the largest stock exchange in India till 1960's. In 1961, there were 1203 listed companies. Of these, 576 were listed on the CSE and 297 on the BSE. However, the latter part 1960's saw significant decline in the share of CSE. But, the share of BSE gained during that period.

Pattern of Growth of Stock Exchanges					
	1946	1961	1971	1975	1980
No of Stock exchanges	7	7	8	8	9
No of listed Companies	1175	1203	1599	1852	2265
Market Capitalizatio (₹ in crores)	971	1292	2675	3273	6750
	1990-91	1999-2000	2004-05	2007-08	2012-13
No of Stock Exchange	22	23	23	21	26
No of listed Companies	2471	5815	4731	4887	5133
Market Capitalisation	90,836	11,2,842	1,698,428	5,138,014	6,214,941
Turnover(₹ in crores)	36,011	20,670,310	1,620,498	5,129,895	3,478,391
Source: SEBI Annual Report, Various issues					

Till 1990's, the Indian Stock Market was suffering from many drawbacks which are enumerated as below:

- Uncertainty of execution prices.
- Uncertain delivery and settlement periods.
- Lack of transparency.

- High transaction costs.
- Absence of risk management.
- Systematic failure of market due to market failure.
- Partiality of brokers to certain client only.

Market Reforms after 1991

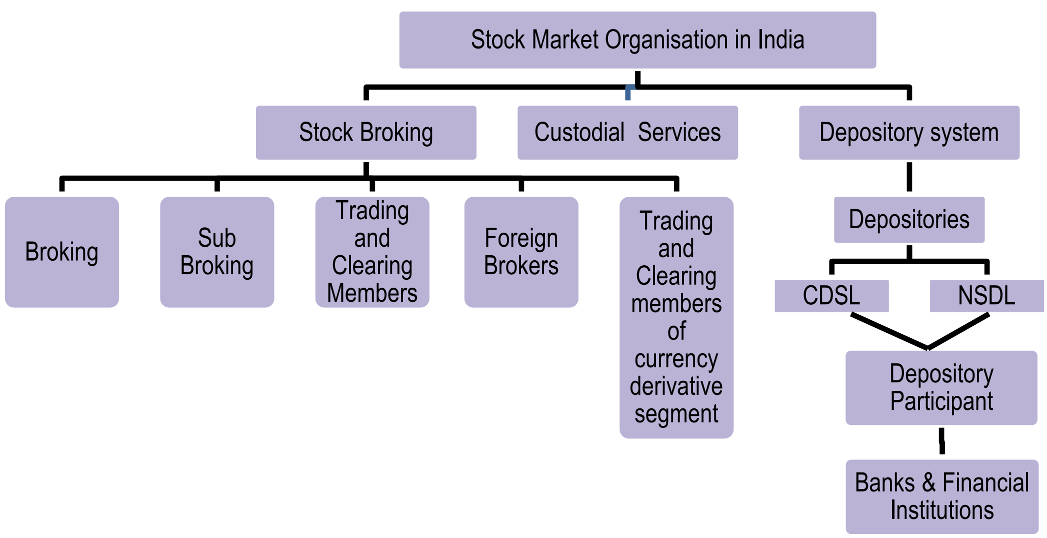
After the initiation of reforms in 1991, the secondary market has adopted the following system:

- Regional stock exchanges
- The National Stock Exchanges (BSE and NSE)
- The Over the Counter Exchange of India (OTCEI)
- The Interconnected Stock Exchange of India (ISE)

The NSE was set up in 1994. It was the first stock exchange in India to bring new technology, new trading practices, new institutions and new products. The OTCEI was established in 1992 providing small and medium sized enterprises the means to generate capital. Metropolitan Stock Exchange of India Ltd. (MSEI), formerly known as MCX Stock Exchange Ltd. (MCX-SX), is recognized by country's securities market regulator - Securities and Exchange Board of India (SEBI). It offers an electronic platform for trading in Capital Market, Futures & Options, Currency Derivatives, Interest Rate Futures (IRF) and Debt Market segments. MSEI's current shareholders include Indian public sector banks, private sector banks, investors and domestic financial institutions.

3. STOCK MARKET ORGANIZATION IN INDIA

The organization of stock exchanges has been depicted in the following figure:



The stock market organization (highlighting the capital market intermediaries) in India as shown in the above diagram is discussed as below:

(i) Stock Broking –Brokers are members of stock exchange. They enter into share trading transactions either on their own account or on behalf of their clients. They have to get registration from SEBI before starting their operations and have to comply with the prescribed code of conduct. Till recently, most of the brokers work as proprietary or partnership concerns. However, now many top broking firms are company form of organizations. Recent examples are:

- Sharekhan Limited
- India Bulls
- Angel Broking Limited
- India Infoline Limited
- Reliance Money
- Kotak Securities Limited
- ICICI Direct
- Motilal Oswal Securities
- HDFC Securities
- Bajaj Capital

Brokers are important intermediaries in the stock market as they bring buyers and sellers together. However, the brokerage on transactions varies from broker to broker. The maximum allowable brokerage is 2.5% of the contract price.

Further, every stock broker should appoint a compliance officer to monitor the compliance of SEBI Act and its various rules, regulations and guidelines and also for redressal of investor grievances. The compliance officer should immediately report any non-compliance observed by him to the SEBI.

SEBI is also empowered to appoint one or more persons as inspectors to inspect the books of accounts, other records and documents of the stockbroker. Also, a stock broker shall only deal with any person as a sub-broker only if he has obtained a certificate of registration from the SEBI. Further, a stock broker or a sub-broker who has contravened any provisions of SEBI Act, rules and regulations are liable for penal actions.

(ii) Custodial Services –The custodians play a critical role in the secondary market. SEBI Custodian of Securities Regulation, 1996 was framed for the proper conduct of their business. According to SEBI regulations, custodial services in relation to securities of a client or gold/gold related instrument held by a mutual fund or title deeds of real estate assets held by a real estate mutual fund mean safekeeping of such securities or gold/gold related instruments or title deeds of real estate assets and providing related services.

The related services provided by them are as follows:

- ❖ Maintaining accounts of the securities of a client.
- ❖ Collecting the benefits/rights accruing to the client in respect of securities.
- ❖ Keeping the client informed of the actions taken by issuer of securities.
- ❖ Maintaining and reconciling records of the services as referred above.

SEBI can also ask for information from the custodian in regard to his activities. Such information has to be given within a reasonable period as laid down by SEBI. Further, SEBI is also empowered to conduct inspection/investigation including audit of books of account, records etc. of custodians to ensure that they are being properly maintained. SEBI's task is also to ascertain that compliance of provisions of SEBI Act and its regulations have been duly complied with. Moreover, his job is also to investigate into complaints received from the investors or clients.

(iii) Depository System – A major reform of the Indian stock markets has been the introduction of the depository system and scripless trading mechanism. The Depository Act was passed in 1996 to provide further fillip to the process.

The issuers should enter into an agreement with the depository to enable the investors to dematerialize the securities.

Before the depository system came into being, the market suffered from various drawbacks including thefts and forgeries of share certificates. Moreover, dealing in the physical mode had its own limitations which inhibited the growth of the capital market in India. These shortcomings were acutely felt more so after the liberalization of the economy. To address all such issues the Central Government enacted the Depositories Act, 1996, with retrospective effect from September 20, 1995.

Is it compulsory for every investor to hold securities in the demat form or can he also hold shares in the physical form? The Depositories Act provides that every person subscribing to securities offered by an issuer has the option to receive the security certificates or hold securities with a depository. However, investors need to note that while securities can be held by way of certificates, dealing in the market is permitted only if the securities are in the demat mode.

When an investor holds securities in the physical form, the certificates bear serial numbers, the distinctive numbers, etc. However, when the securities are held in demat mode, they are akin to money lying in the bank account. Therefore, there is no question of certificate numbers or distinctive numbers, though the quantity will remain the same.

As in the case of certificates, holders of securities in demat mode (called beneficial owners) can create a pledge or hypothecation in respect of the securities held by them. In such cases, it is necessary for the beneficial owner to inform the depository of the pledge or hypothecation created by him. The depository concerned has to make a noting in its records to that effect.

Can the investor, who has opted for holding the securities in demat form, ask for certificates on opting out of the depository. A beneficial owner has a right to opt out of the depository at any time he or she may desire. In fact, the depository has to note the request in its records and also convey the same to the company. The company is obliged to issue the certificates in respect of the securities within 30 days of the receipt of the intimation from the depository.

What can an investor do if a depository or any participant or an issuer fails to redress his grievances? A complaint should be lodged with Sebi giving the necessary particulars in the prescribed form. Sebi would write to the concerned party asking it to redress the grievances of the investors within a specified time. In exceptional circumstances Sebi may grant further time for redressing the grievances. However, if the depository or the participant indulges in dilatory tactics or neglects to redress the grievances, Sebi has power to proceed against such defaulting party and impose penalty. In fact, Sebi has come down heavily on various market intermediaries as also the defaulting companies which ignore the investors and fail to redress their grievances. The heavy penalties that Sebi can impose and in many cases it has done so have come as an eye opener for various market players. *(Source: Financial Express)*

<u>Secondary Market Structure</u>

SEBI Registered Market Intermediaries

Market Intermediaries	2010-11	2011-12	2012-13	2013-14	2014-15	Apr 14-Dec 14	Apr 15-Dec 15
1	2	3	4	5	6	7	8
Stock Exchanges (Cash Market)	19	19	19	16	15	14	5
Stock Exchanges (Derivatives Market)	2	2	3	3	3	3	3
Stock Exchanges (Currency Derivatives)	4	4	4	4	3	3	3
Stok Exchanges (Commodity Derivatives Market)	Na	Na	Na	Na	Na	Na	12
Brokers(Cash Segment)	9,235	9,307	10,128	9,411	5,899	7,306	4,824
Corporate Brokers(Cash Segment)	4,563	4,672	5,113	4,917	3,677	4,196	3,405
Sub-brokers(Cash Segment)	83,952	77,165	70,178	51,885	42,409	44,540	36,683
Brokers(Equity Derivatives)	2,301	2,337	2,957	3,051	2,761	3,008	2,762

Brokers(Currency Derivatives)	1,894	2,173	2,330	2,395	2,404	2,406	2,408
Foreign Institutional Investors	1,722	1,765	1,757	1,710	Na	Na	Na
Sub-accounts	5,686	6,322	6,335	6,344	Na	Na	Na
Foreign Portfolio Investors (FPIs)	Na	Na	Na	Na	1,444	782	3,491
Deemed FPIs	Na	Na	Na	Na	6,772	7,360	5,114
Custodians	19	19	19	19	19	19	19
Depositories	2	2	2	2	2	2	2
Depository Participants	805	854	865	857	854	858	853
Merchant Bankers	192	200	199	197	197	198	191
Bankers to an Issue	55	56	57	59	60	60	62
Underwriters	3	3	3	3	2	2	2
Debenture Trustees	29	32	32	31	32	32	31
Credit Rating Agencies	6	6	6	6	6	6	7
KYC Registration Agency (KRA)	Na	Na	5	5	5	5	5
Venture Capital Funds	184	207	211	207	201	201	200
Foreign Venture Capital Investors	153	175	182	192	204	201	213
Alternative Investment Funds	Na	Na	42	101	135	125	189
Registrars to an Issue & Share Transfer Agents	73	74	72	71	72	71	73
Portfolio Managers	267	250	241	212	188	193	201
Mutual Funds	51	49	52	50	47	49	47
Investment Advisors	Na	Na	Na	129	271	239	373
Research Analysts	Na	Na	Na	Na	26	0	233
Collective Investment Management Company	1	1	1	1	1	1	1
Approved Intermediaries (Stock Lending Schemes)	2	2	2	2	2	2	2
STP (Centralised Hub)	1	1	1	1	1	1	1
STP Service Providers	2	2	2	2	2	2	2

Source: SEBI handbook of statistics

4. DEMUTUALIZATION OF STOCK EXCHANGES

Demutualization is the process by which any member owned organization can become a shareholder owned company. Such a company can either be listed on a stock exchange or be established as a closely held company. In simple words, a demutualized stock exchange is basically a company form of organization in which the company goes public and owners will be given equity shares.

Earlier (i.e. prior to 1991), all stock exchanges in India are broker owned and broker controlled. In other words, it is the brokers who collectively owned, controlled and managed these exchanges. However, the ownership and managership of these stock exchanges led to a conflict of interest where the interest of these brokers was given prominence than the investors.

These led to price rigging, frequent payment crises on stock exchanges and misuse of official position by office bearers. Therefore, demutualization of stock exchange was resorted to instill confidence in the minds of the investors.

So, through the demutualization process, a stock exchange becomes a profit making company and a tax paying entity. Demutualization separates the ownership and control of stock exchange from the trading rights of members. This reduces the conflict of interest and also the chances of brokers using the trading mechanism for personal gains.

In November 2002, SEBI approved the uniform model of corporatization and demutualization of stock exchanges, recommended by the Kania Committee. Further, Securities Contract Regulation Act was amended on October 12, 2004, through an ordinance, making it compulsory for the exchanges to convert into corporate entities and delink their broker members from the management. The ordinance restricts brokers' representation in the governing body of stock exchanges to 25%. It also reduces their shareholding from 100% to 49%. Moreover, 51% of the stake of the stock exchange should be held by the public. This segregation was initiated to safeguard the interest of shareholders, bring greater transparency and efficiency of stock exchanges.

Advantages of Demutualization

(i) Enable stock exchanges to have more access to funds for investment in technology.

(ii) Facilitate merger and acquisition of other exchanges.

(iii) Facilitate alliances with other stock exchanges.

(iv) Benefit to members of the stock exchange as their asset becomes liquid.

(v) Members get share of the profits made by exchanges through dividends.

(vi) Makes operations of the stock exchanges transparent.

(vii) Transparency brings better governance.

5. SHARE TRADING IN SECONDARY MARKET

Secondary Market or Stock Exchange Market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. Majority of the trading is done in the secondary market. Secondary market comprises of equity markets and the debt markets. For the general investor, the secondary market provides an efficient platform for trading of his securities. For the management of the company, secondary equity markets serve as a monitoring and control conduit—by facilitating value-enhancing control activities, enabling implementation of incentive-based management contracts, and aggregating information (via price discovery) that guides management decisions. *[Source: moneycontrol.com]*

5.1 Share Trading by a Retail Investor

One can either choose to trade online or via a stockbroker or investment firm or an agent. One needs to take following steps to conduct trade in secondary market in India:

(i) Open a Bank Account: The first step towards investing in Indian stock market is to open a bank account. A bank account is required to hold the funds which would be investing in secondary market.

(ii) Open a Demat Account: Just as a bank account is required to hold the funds, a Demat Account is required to hold and trade the securities i.e. Shares, debentures and mutual funds electronically.

(iii) Open a trading account: After opening a Demat account, a trading account is required to trade in securities market. A trading/brokerage account allows you to purchase stocks, bonds, mutual funds, and other units by paying the broker to do the trading on your behalf. A retail investor would not be able to do trading without a trading account. Now, many banks have started providing all these services in a single unified account. The trading platform of a stock exchange is accessible only to trading members. The brokers would give buy/sell orders either on their own account or for their clients.

(iv) Trading Mechanism: With the advent of technology, trading at stock exchanges are now taking place through an open electronic limit order book, in which order matching is done by the trading computer. The buy or sell orders placed by the investors are matched automatically with the order which is best for them. Because of these, the buyers and sellers do not come to the picture. In other words, they remain anonymous. The market driven by order as stated above eliminates opaqueness. It brings transparency by highlighting all buy and sell orders in the trading system. But, the presence of market makers is very important. In their absence, there might by a possibility of non-execution of any order.

Investors buy/sell securities on stock exchange platform by placing buy/sell orders through their stock brokers with whom they are registered as client. On successful execution of order (buy/sell), securities will be bought/sold on behalf for the client. This activity is known as buying/selling of securities on the stock exchange platform on specific days which is known as trading day. This activity is referred to as trading and is carried out by stock exchanges for a specific period called trading hours. After the trading activity is completed, the process of delivering securities by the seller and payment of funds by the buyer is called securities pay-in/funds pay-in respectively. This activity also has to be conducted within a stipulated time period. After the pay-in process is completed successfully, the buyer will get shares and the seller will get money. The above mentioned activities of, pay-in and, payout are collectively referred to as settlement process. Each settlement is identified by a unique number called settlement id/Settlement number.

(v) Payment to Broker for purchase of shares/securities: The payment for the shares purchased is required to be done prior to the pay-in date for the relevant settlement or as otherwise provided in the Rules and Regulations of the Exchange.

(vi) Delivery of shares to the broker for sale: The delivery of shares has to be done prior to the pay- in date for the relevant settlement or as otherwise provided in the Rules and Regulations of the Exchange and agreed with the broker/sub broker in writing.

(vii) Receipt of money for a sale transaction and receipt of shares for a buy transaction: Brokers were required to make payment or give delivery within two working days of the pay - out day. However, as settlement cycle has been reduced fromT+3 rolling settlement to T+2, the pay out of funds and securities to the clients by the broker will be within 24 hours of the payout.

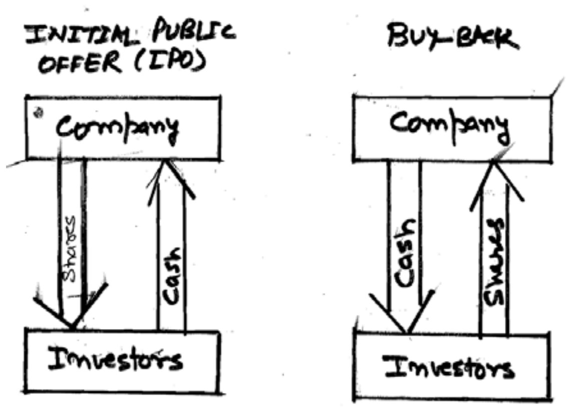
5.2 Buy Back of Shares

What is a buyback?

The buyback is a process in which a company uses its surplus cash to buy shares from the public. It is almost the opposite of initial public offer in which shares are issued to the public for the first time. In buyback, shares which have already been issued are bought back from the public. And, once the shares are bought back, they get absorbed and cease to exist.

For example, a company has one crore outstanding shares and having a huge cash pile of ₹ 5 crores. Since, the company has very limited investment options it decides to buyback some of its outstanding shares from the shareholders, by utilizing some portion of its surplus cash. Accordingly, it purchases 10 lakh shares from the existing shareholders by paying₹ 20 per share, i.e. total cash of say, ₹ 2 crore.

The concept of buyback can be cleared with the help of the following diagram:



Effects of Buyback

There are several effects or consequences of buyback, some of which are as follows:

(i) It increases the proportion of shares owned by controlling shareholders as the number of outstanding shares decreases after the buyback.

(ii) Earning Per Share (EPS) escalates as the number of shares reduces leading the market price of shares to step up.

(iii) A share repurchase also effects a company's financial statements as follows:

(a) In balance sheet, a share buyback will reduce the company's total assets position as cash holdings will be reduced and consequently as shareholders' equity get reduced it results in reduction on the liabilities side by the same amount.

(b) Amount spent on share buybacks shall be shown in Statement of Cash Flows in the "Financing Activities" section, as well as from the Statement of Changes in Equity or Statement of Retained Earnings.

(iv) Ratios based on performance indicators such as Return on Assets (ROA) and Return on Equity (ROE) typically improve after a share buyback. This can be understood with the help of following Statement showing Buyback Effect of a hypothetical company using ₹ 1.50 crore of cash out of total cash of ₹ 2.00 crore for buyback.

	Before Buyback	After Buyback (₹)
Cash (₹)	2,00,00,000	50,00,000
Assets (₹)	5,00,00,000	3,50,00,000
Earnings (₹)	20,00,000	20,00,000
No. of Shares outstanding (Nos.)	10,00,000	9,00,000
Return on Assets (%)	4.00%	5.71%
Earnings Per Share (EPS) (₹)	2	2.22

As visible from the above figure, the company's cash pile has been reduced from ₹ 2 crore to ₹ 50 lakh after the buyback. Because cash is an asset, this will lower the total assets of the company from ₹ 5 crore to ₹ 3.5 crore. Now, this leads to an increase in the company's ROA, even though earnings have not changed. Prior to the buyback, its ROA was 4% but after the repurchase, ROA increases to 5.71%. A similar effect can be seen in the EPS number, which increases from ₹ 2 to ₹ 2.22.

Why buybacks are being favoured by companies?

There are several reasons why a company chooses buyback, some of which are as follows:

(i) A business organization needs cash to either expand its operations through acquisition of other businesses or grow its capacity by purchasing machinery, plant, furniture or other kinds of assets. Therefore, too much cash is not considered good as it shows that cash is lying idle without being utilized in any manner.

(ii) A company may reduce some of its dividend liability by buying back shares thereby providing cash in the hands of shareholders and reducing cost.

(iii) Also, company will save on the dividend distribution tax @15% if they opt for buy back instead of declaring dividend to shareholders.

(iv) Further, a company's earnings per share (EPS) increases as the numbers of shares reduce because EPS is PAT (Profit after Tax) divided by total outstanding shares. This leads to spurt in the market price of shares.

(v) Moreover, by going for buyback, the company may give a signal to the investors that there are not any worthwhile investment opportunities for the company to increase capacity or through acquisitions.

(vi) Another reason to opt for buyback is when a company feels that the current market value of its shares is underpriced and is confident of its business and potential future value to investors.

When investors should opt for buyback?

The investors may opt for buyback of shares if the price offered to them is at a premium on the market price. In such a scenario, the buyback may be an attractive proposition. For example in case of Tata Consultancy Services (TCS) buyback, the offer price is ₹ 2850 per share while the current market price is around ₹ 2505. So, in case of TCS, offer price is at about 14% premium.

Further, if a shareholder goes by the famous quote, "a bird in the hand is worth two in the bush", he may be inclined to accept the buyback offer, if buyback premium is more than the market price. However, if the investors can make out that management is continuously putting its effort to improve shareholder value, then the long term investor may not go for the buyback offer. The reason is that may be, in the next few years, market price of shares may upstaged the premium price of buyback offer.

On the other hand, opting for a buyback makes sense if the share price in the market is overvalued (i.e. there is very little chance that share price may increase any further in near future), or if there is firm belief that there are not enough opportunities for a firm to grow earnings.

Also, High Net Worth Individuals (HNI) having large shareholdings will not have to pay 10% tax on dividend income had they opted for the company's buy back scheme because if their dividend income crosses ₹ 10 lakh, they would have to pay an additional dividend tax on the excess income.

Factors to be considered in buy back option by the investor

Acceptance ratio is also a very important factor in buy back. Acceptance ratio is the proportion of shares accepted by the company from the shareholders for buyback out of the shares tendered by the shareholders. In case of the buyback offer of TCS, only 3% of total shares tendered by each of shareholders are accepted by the company. So, if we go by the TCS example, if a shareholder is holding e.g. 1000 shares, it doesn't mean that TCS will buyback all the 1000 shares. In this case, it will buyback only 30 shares.

Another factor which is to be considered by investors while buying back the shares of a particular company is that whether promoters are participating in buyback or not. If there is promoter participation, the buyback is likely to be positive for the shares in the long run.

Delisting versus Buyback

Generally delisting is confused with buyback which is wrong since it is the process by which a listed security is removed from the exchange on which it trades. The major differences between buyback and delisting of shares are as follows:

(1) In case of delisting, buyback of shares compulsorily happens while buyback offer does not lead to delisting of shares.

(2) Delisting can happen in case of two circumstances. One, a company may delist its shares voluntarily. Two, a company's stock may be compulsorily removed from an exchange if the company does not comply with the listing requirements of the exchange. However, there is no compulsion upon a company to execute buyback.

(3) In case of delisting, entire share capital of the company is extinguished. But, in case of buyback, only some portion of the total capital is offered to the shareholders for buyback.

(4) Delisting can happen in case of a listed company only. While buyback can take place in case of both listed and unlisted company.

Legal implications of Buyback

As per the Companies Act, the buyback is allowed to a company, if it is meeting the prescribed requirements and that too from permitted resources such as Free Reserves, Securities Premium etc. Further company can buyback upto 25% of its total paid up capital and free reserves.

6. STOCK MARKET AND ITS OPERATIONS

The stock exchanges are meant to facilitate mobilization of resources by companies. Their effective regulation is required for protecting the interests of investors and safeguarding their developmental role.

The Securities Contracts (Regulation) Act 1956 along with the Securities Contracts (Regulation) Rules 1957 has been the main laws to regulate the securities market in India. As per the Securities Contracts Regulations Act, 1956, a stock exchange is defined as "an association, organization or body of individuals whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities". A look at the powers given to stock exchanges in India to make and enforce by laws under the Act and the rules reveals that Indian Stock Exchanges have been envisaged as self-regulatory organizations.

6.1 Growth of Stock Exchanges

The stock exchange in India came into existence in the eighteenth century. At that time, securities of East India Co. were transacted. And, there were at the most 50-60 brokers led by Premchand Roychand. They provided the much needed impetus to the shares issued by East India Company and a few commercial banks. The issuance of shares of a company made their beginning in the 1830s and gained importance with the passage of Companies Act in 1850s. The stock exchange in India, the Bombay Stock Exchange was established in 1875. It's name at that time was "Share and Stockbrokers Association."

The stock exchanges are tightly regulated as self-regulatory organizations (SROs) under the Act. In addition to ordinary regulatory powers over the stock exchanges, the Central Government and/or SEBI may nominate up to three members to the board of each stock exchange [Section 4(2)(iii) of the SC(R) Act, 1956 and Section 10 of SC(R) Rules, 1957]. The government and/or the agency have the authority to make, approve and amend the byelaws of the stock exchanges [Section 4(1)(a) & 8 of the SC(R) Act, 1956]. In return, the stock exchanges have been granted a strong disciplinary authority (as well as obligations) over their member stockbrokers.

6.2 Characteristics of Stock Exchanges in India

A stock exchange is an association of brokers, who are its members, established with the objective of regulating and helping the buying and selling of securities by the organizations. Recognition to a stock exchange in India is provided by the Central Government after making such inquiry as may be necessary after satisfying the provisions of the Securities Contract (Regulation) Act, 1956.

The governance of a stock exchange is done by the Board of Directors. Some board members are nominated by the Government. And, Govt. nominees include people representing Ministry of Finance. There, are some public representatives also whose job is to protect the interest of investors.

Further, the Board is presided by a President, who is nominated by the government from among the elected members. The Executive Director (ED) is the operational chief of stock exchange. He is appointed by the Stock Exchange with government's approval. The duty of ED is to make sure that day to day operations of the stock exchange are carried out in accordance with the rules and regulations.

The office of SEBI has been set up in Mumbai to observe the proper functioning of stock exchanges in the country. Every company wishing to issue shares to public has to get its securities listed in atleast one stock exchange. Stock exchanges also facilitate trading of shares listed in them.

6.3 Functions of Stock Exchanges

Various functions of stock exchanges are discussed as below:

(a) Liquidity and Marketability of Securities: The basic functions of the stock market are to provide liquidity to the securities of a company. This can be achieved when investors can sell their securities at the prevalent market price at that time and get the required amount. The stock exchanges also provide marketability to the securities of a company i.e. the securities can be bought and sold at any time at the convenience of investors.

(b) Fair Price Determination: Fair price is determined through the demand and supply forces. As the market is almost perfectly competitive, there are large number of buyers and sellers that ensures an honest and just determination of prices of securities.

(c) Source for Long term Funds: Stock exchanges provide a reliable long term sources of funds to the corporates, government and the public bodies. The advantages of the securities place in the stock exchanges are that they are negotiable and transferable. They are freely traded and changes hands from one investor to other without affecting the funds requirement of the issuing company.

(d) Helps in Capital Formation: It means the savings of the people are mobilized and channelized into those sectors which are in need of money. So, stock exchanges facilitate capital formation i.e. it helps in transfer of funds from those people who have surplus money to sectors which are in need of money.

(e) Services provided by Stock Exchanges: Stock exchanges ensure that the shares issued to the public are transparent and according to prescribed rules and regulations.

Shares are issued to the public by the companies by disclosing all the information through the prospectus. It ensures that various norms regarding listing, opening of subscription for a minimum number of days, availability of share applications at the prescribed centres etc.

Members of the stock exchanges provide useful services as brokers and underwriters. As brokers, they try to gain access to potential investors and encourage them to invest in the stock market. And, as underwriters, they provide the much needed services by subscribers to those securities of a company which remains unsubscribed.

Stock exchanges also provide a platform where right shares of a company are issued to the already existing shareholders of the company. New shareholders can also take part in the rights shares provided existing shareholders renounce a part of their shareholding.

(f) Reflects the General State of Economy: The stock market is a reflection of an economy. When economy is doing badly, the stock market also reflects the same negativity in the form of declining share prices. On the other hand, when the economy is doing well, the stock market also shows a boosting effect in the form of higher share prices.

6.4 Basics of Stock Market Indices

6.4.1 Stock Market Index

It represents the entire stock market. It shows the changes taking place in the stock market. Movement of index is also an indication of average returns received by the investors. With the help of an index, it is easy for an investor to compare performance as it can be used as a benchmark, for e.g. a simple comparison of the stock and the index can be undertaken to find out the feasibility of holding a particular stock.

Each stock exchange has an index. For instance, in India, it is Sensex of BSE and Nifty of NSE. On the other hand, in outside India, popular indexes are Dow Jones, NASDAQ, FTSE etc.

6.4.2 Concept behind Fluctuations of Index

Valuation of stocks is arrived at by discounting future earnings (i.e. dividend and capital gains) to arrive at the present value. So, the stock market is basically reflective of how a company will perform in the future. So, when the index goes up, the perception is that the future returns will goes up and vice-versa.

6.4.3 Computation of Index

Following steps are involved in calculation of index on a particular date:

❖ Calculate market capitalization of each individual company comprising the index.

❖ Calculate the total market capitalization by adding the individual market capitalization of all companies in the index.

❖ Computing index of next day requires the index value and the total market capitalization of the previous day and is computed as follows:

$$\text{Index Value} = \text{Index on Previous Day X } \frac{\text{Total market capitalisation for current day}}{\text{Total capitalisation of the previous day}}$$

❖ It should also be noted that Indices may also be calculated using the price weighted method. Here, the share price of the constituent companies forms the weight. However, almost all equity indices world-wide are calculated using the market capitalization weighted method.

7. RISK MANAGEMENT IN SECONDARY MARKET

The stock exchanges have developed a comprehensive risk management mechanism to promote a safe and efficient capital market. These include:

❖ Laying down trading rules and regulations for broker members.

❖ Setting up market surveillance systems to curb excess volatility.

- Creating trade/settlement guarantee fund to ensure timely settlements even if a member defaults to deliver securities or pay cash.
- Setting up a clearing corporation to guarantee financial settlement of all trades and thereby reduce credit risk in the settlement system.

The Risk Management structure of Secondary Market (or stock exchanges) has been discussed in detail in the following paragraphs to enable students to have a good grasp over the nuances of secondary market.

I. Trading Rules and Regulations

Strict rules and regulations have been framed to prevent unfair trading practices and insider trading. Stock exchanges impose different types of margins on brokers for individual stocks, depending upon the exposures taken by these brokers in these stocks, both on ownership basis and on behalf of clients. These margins are collected to prevent brokers from taking market positions in excess of their buying capacity. They are also used to settle any amount due to the stock exchange, clearing corporation and traders, in case the broker faces any shortage of amount.

Further, there is a real time monitoring of the intra-day trading limits and gross exposure limits by the stock exchanges. There is an automatic deactivation of trading terminals in case of breach of exposure limits. Also, SEBI stipulated that stock brokers and sub-brokers of one exchange cannot deal with the brokers and sub-brokers of the same exchange either for proprietary trading or for trading on behalf of their clients. However, they can deal with the brokers and sub-brokers of another exchange for proprietary trading only.

Moreover, to ensure fair trading practices, the SEBI has devised insider trading regulations by prohibiting insider trading and making it a criminal offence. To ensure transparency in the takeover process, SEBI takeover regulations have been made.

II. Circuit Breakers to curb excess volatility

Circuit Breaker is a temporary halt or suspension of trading in any particular stock or index for certain period of time. The move is basically resorted to curb excess volatility in the stock market.

There are two methods by which circuit breakers are practiced:

1. Suspension of trade in a security or index for a certain period.
2. Suspension of trade in a security or index for the entire trading day.

In case of first option, trading activities are suspended for few hours to enable the market to settle down. This also allows market participants to make an informed decision by having a relook at the market. If the market is very volatile and it seems that it is going out of control, then the trading may be halted for the entire day.

Advantages of Circuit Breakers

(i) During the suspension period, circuit breakers allow participants to reassess the situation by gathering new information.

(ii) It helps in controlling panic among the investors.

(iii) It also helps exchange clearing houses to monitor their members.

(iv) It also helps investors to take a rational approach towards the security during the time the trading is suspended.

Disadvantages of Circuit Breakers

(i) Firstly, circuit breakers prevents true discovery of price for the period during which it is imposed.

(ii) Secondly, sometimes circuit breakers prove to be unfair to retail investors because well informed investors such as foreign institutional investors usually makes a move before the circuit breaker can be invoked leading to chaos and confusion among retail investors.

The extent of duration of the market halt and pre-open session is as given below:

Circuit Breaker

Trigger limit	Trigger Time	Market halt duration
10%	Before 1 p.m.	1 Hour
	At or after 1 p.m upto 2.30 pm	30 minute
	At or after 2.30 p.m	No halt
15%	Before 1p.m	2 hours
	At or after 1 p.m upto 2 p.m	1 hour
	On or after 2 p.m	Remainder of the day
20%	Any time during market hours	Remainder of the day

III. Trading and Settlement

Rolling settlement is basically settlement of transaction in stock market in a certain number of days after the trade is agreed.

Rolling settlement can be explained with the help of following table:

Rolling Settlement

Activity	Description of Activities	Day	Timings
Trading	Trading by investors	T day	
Clearing	National Securities Clearing	T + 1	By 1.30 P.M.

	Corporation Ltd. (NSCCL) confirms the trade from stock exchange. Then, NSCCL process and download obligation files to brokers.		
Settlement	Pay-in of securities and funds to NSCCL. NSCCL gives pay out of securities and funds.	T + 2	By 10.30 A.M. By 1.30 P.M.

The above chart has been explained in the next paragraph:

Trading Day (T Day)

T stands for trading. Trading can be done during the entire day i.e. from 9.00 A.M. to 3.30 P.M. Trading can be done on any working day (except Saturday and Sunday and other holidays as intimated by the stock exchange from time to time). During the trading process, one investor buys the shares and other investor purchases the shares. After the execution of trading, the buyer receives the shares and the seller receives money for the shares he parted.

Clearing Activities (T+1 day)

Clearing is a process of determination of obligations, after which obligations are discharged by settlement. On the T+1 day i.e. one day after the trading day, first of all, the National Securities Clearing Corporation Ltd. (NSCCL) confirms the trade executed during the day from the Stock Exchange which helps it to determine the obligation of each member (broker) in terms of funds and securities. After that, the netting of obligations is done. This entire process of determining the obligation is done by the custodians/clearing corporation which works under the NSCCL. Once the netting of obligation is done, all the files are processed and downloaded so that each broker knows what he has to pay-in and receive.

Netting explained

Suppose, an investor buys 100 shares @ ₹ 2000 each on Monday and sell those shares @ 2500 each on the same day. His net obligation in terms of funds and securities will be calculated on Tuesday. In terms of securities, his net obligation is nil as he has sold all the shares he bought. So, he will neither receive nor give any security. On the other hand, his net monetary obligations will be calculated taking into account his buying and selling amount. In this case, the net amount he is receiving is ₹ 50000 (100 shares x ₹ 2500 – 100 shares x ₹ 2000).This pay-in and pay-out of funds are calculated on T+2 day i.e. on Wednesday.

Settlement Activities (T+2 Day)

On the second working day i.e. T+2 day, all the brokers has to pay-in the required funds and securities to the NSCCL by 10.30 A.M. giving the required instructions to the respective clearing banks and members on the same day. Moreover, by 1.30 on the same day, brokers get the required funds through the NSCCL. This is called pay-out of funds.

Pay-in and pay-out of funds explained

Pay-in of funds take place when NSCCL gives the required funds to the clearing corporation by giving instructions to the clearing bank which credits the account of clearing corporation and debit the accounts of clearing bank. This is called pay-in of funds. After that, the NSCCL gives electronic instructions to the clearing banks to credit accounts of clearing members and debit accounts of the clearing corporation. This is called pay-out of funds and this completes the settlement cycle.

Pay-in and pay-out of securities explained

Pay-in of securities means that shares that the shareholder wants to sell are picked up from their Demat account and transferred to the broker's account. All these shares are then delivered to the clearing corporation. In pay-out of securities, the shares that the investor wants to buy are received from the clearing corporation and then transferred to the broker's account. After that, the shares are transferred from the broker's account to the buyer's demat account.

IV. National Securities Clearing Corporation Limited

In April 1995, the NSE set up the National Securities Clearing Corporation Limited (NSCCL), its wholly owned subsidiary, to undertake clearing and settlement at the exchange. It started operations from April 1996.The NSCCL undertakes the counter party risk of each member and guarantees settlement. Settlement guarantee is a guarantee provided by the clearing corporation for the settlement of all trading of products in the stock exchange. The organizations linked with Clearing Corporation in the clearing and settlement process are discussed as below:

(a) **Custodians/Clearing Members:** NSCCL takes trading information from the exchange and pass the trade details to custodians/clearing members. Custodians confirm the obligations of the parties by netting.

(b) **Clearing Banks:** They act as a link between clearing corporation and clearing member. Every clearing member is required to maintain a clearing account with one of the clearing banks. A clearing bank has to enter into an agreement with the NSCCL and clearing member and open clearing account with the depository.

(c) **Depositories:** They hold securities in dematerialized form for the investors in their beneficiary account. Every clearing member is required to maintain a clearing pool account with the depositories.

The clearing banks, on receiving electronic instructions from the NSCCL, debit accounts of clearing banks and credit accounts of the clearing corporation. This is termed as pay-in of funds and securities. The NSCCL, after providing for shortages of funds and securities, sends electronic instructions to the depositories and clearing banks to credit accounts of clearing members and debit accounts of the clearing corporation. Thus, the settlement cycle is completed once the pay out of funds and securities is done.

V. Market Making System

The job of the market maker is to provide liquidity to the stock market by providing a two way quote i.e. a buy and a sell quote. How the market makers do this? And what is the purpose. Consider a situation, when you want to purchase shares and there is no one there to sell his share. What will happen? Such a person has to wait until he finds a person who can sell his shares at a price quoted by him. The market maker resolves this problem. He sells shares at the quoted price. This way, the person gets the shares he wants to sell. Conversely, if a person wants to sell his shares, market maker may come at his rescue and purchase shares at the price quoted by him. So, he gets the shares he was so willing to purchase. Hence, market maker has devised a system in which anyone can buy and sell shares anytime.

Market makers are basically large brokerage houses. But, how do they make money? And, there is a chance that they may suffer loss. For e.g. if they buy shares at a particular price and are not able to sell them later at a higher price because of fall in market price of shares, they will incur loss. To offset this loss, they purchase shares at a particular price (ask price) say ₹ 100 and sell them at a slightly higher price say ₹ 100.10 (bid price). This profit margin of 0.10 seems to be very nominal. But, when trading of millions of shares takes place in a day, the market maker at the end of the day managed to pocket a significant amount.

The obligations and responsibilities of Market Makers (as per BSE website)

The Market Maker shall fulfill the following conditions to provide depth and continuity on this exchange:

(a) The Market Maker shall be required to provide a 2-way quote for 75% of the time in a day. The same shall be monitored by the stock exchange. Further, the Market Maker shall inform the exchange in advance for each and every black out period when the quotes are not being offered by the Market Maker.

(b) The minimum depth of the quote shall be ₹ 1,00,000/- . However, the investors with holdings of value less than ₹ 1,00,000 shall be allowed to offer their holding to the Market Maker in that scrip provided that he sells his entire holding in that scrip in one lot along with a declaration to the effect to the selling broker.

(c) Execution of the order at the quoted price and quantity must be guaranteed by the Market Maker, for the quotes given by him.

(d) There would not be more than five Market Makers for a scrip. These would be selected on the basis of objective criteria to be evolved by the Exchange which would include capital adequacy, networth, infrastructure, minimum volume of business etc.

(e) The Market Maker may compete with other Market Makers for better quotes to the investors;

(f) Once registered as a Market Maker, he has to start providing quotes from the day of the listing / the day when designated as the Market Maker for the respective scrip and shall be subject to the guidelines laid down for market making by the exchange. Once registered as a Market Maker, he has to act in that capacity for a period as mutually decided between the Merchant Banker and the market maker.

(g) Further, the Market Maker shall be allowed to deregister by giving one month notice to the exchange.

VI. Securities Lending and Borrowing (SLB)

Securities lending means lending of stocks, derivatives and other securities to investor or firm. Securities lending requires the borrower to pledge, whether cash, security or a letter of credit to the lender. When a security is lent, the title and the ownership are also transferred to the borrower.

Why securities lending and borrowing is important? The Securities lending and borrowing has its importance in short selling. Basically, short selling is a facility in which a person (short seller) can sell shares which he does not own or possess. What is the advantage of doing that? The short seller borrows security to immediately sell them. He generally does that when he has a firm belief that security prices will come down in the near future. So, he borrows security hoping to profit by selling the security and buying it back at a lower price. The borrower of securities pays the lender interest on the value of the securities borrowed.

The concept of short selling has been discussed in detail later in this chapter.

The borrower of securities are usually brokers, speculators, market makers, custodian banks, clearing banks, clearing corporation, and finance companies. The lenders are mutual funds, insurance companies, custodian banks, finance companies, brokers and high net worth individuals.

Further, the lender still remains the owner of stock after SLB and gets all beneficial rights such as dividend, rights or bonus shares in respect of the stock lent. The borrower, however, has the legal title of the borrowed securities and is eligible to trade and sell securities in any manner he thinks fit. Moreover, there is roll over facility also i.e. the lender and borrower can extend the period of their borrowing and lending respectively.

Merits of Stock Lending and Borrowing

(i) Provides facility to the borrowers who are anticipating fall in the market price of securities to sell securities which they don't own.

(ii) Provides an incentive to institutional investors such as banks, mutual funds, financial institutions and insurance companies to earn income by lending their idle stock in the market and earn interest income from borrowers.

(iii) Increase liquidity of the stock as more and more people can sell or purchase stock inspite of shortage of money.

(iv) Providing stability to stock market movements.

(v) Helps to avoid delivery failures as it is routed through the clearing house and facilitates timely delivery.

(vi) And, lastly, manipulation of stock prices is difficult.

VII. Straight Through Processing (STP)

The concept of Straight Through Processing is designed to complete the transaction without human intervention. Straight through processing (STP) is an initiative that financial companies use to optimize the speed at which they process transactions. This is performed by allowing information that has been electronically entered to be transferred from one party to another in the settlement process without manually re-entering the same pieces of information repeatedly over the entire sequence of events.

The primary purpose of STP is to streamline the processing of transactions across multiple points. By allowing information to pass along electronically, this eliminates the need for a hands-on reentry of data that has already been completed at the source. Additionally, information could be sent to more than one party simultaneously if it is appropriate for the transaction type.

So, the purpose of STP is to eliminate costly delays during transaction processing period. Since manual assistance is not needed, there is no delay between one party receiving information and the other being able to proceed further.

In normal processing, information must be handled by the multiple persons involved. This requires taking the time to accept and review the information, rekeying data as required, and then sending it forward to the next part of the transaction process. STP eliminates the human factor, allowing an automated process to complete any steps needed for a transaction to proceed. By eliminating these delays, the transactions can be more cost-effective as they require less time to manage. This is particularly attractive to investors looking for lower fee options.

The benefit of STP can be explained with the help of an example. In a manual trade, the broker issues a contract note which is then passed on to the custodian or a depository participant. There are multiple data entries during the different stages of a manual trade which makes the process prone to errors, delays and manipulation. However, in STP, contract note is issued in electronic form and the trade is settled in computer leaving almost no scope for manipulation. Further, in comparison to manual trade, STP is quicker, risk free and eliminates any failure in trade. *(Source: Investopedia)*

VIII. Margin Trading

Margin Trading is a facility given to the investors in which they can invest in shares by part financing from the bank. In other words, investors can provide some amount of money from their pocket to invest in shares, and rest of the amount will be financed by the banks. Margin trading permits investors to buy shares by providing 40% of the total value as margin, while borrowing 60% from the banks.

For example, an investor wants to buy 20000 shares worth ₹ 2,00,000 (price of one share is ₹ 10). But, he can invest only ₹ 80000 from his own pocket. However, under margin trading, he can buy as many as 20000 shares worth ₹ 200000 from his broker by paying ₹ 80000 as margin and by borrowing the balance ₹ 120000 from a bank through his broker. The broker pledges 20000 shares with the bank. The bank has collateral of ₹ 200000 backing the loan of ₹ 120000.

Now, suppose, the market price of share moves upwards from ₹ 10 to ₹ 15. So, with the help of the facility of margin trading, the shareholder can sell his entire shareholding of 20000 shares and pocket a gain of ₹ 100000 (20000 shares x ₹ 15 – 20000 shares x ₹ 10). Conversely, if he hadn't availed the facility of margin trading, he would have been able to sell only 8000 shares and pocketed a gain of ₹ 40000 only. The reason is that he would have purchased only 8000 shares because of paucity of funds.

On the other hand, if the market price of shares fall below ₹ 10, the bank will give a margin call under which the investors will have to furnish additional funds/securities for the broker to pass on to the bank.

Margin trading gives a unique opportunity to the bank to lend short term funds at a high rate of interest. However, banks have to evolve a suitable risk management mechanism to safeguard the loans given by them against collateral of securities. In the same way, it provides a facility to the investors to borrow to money from the bank and invest it in the stock market.

IX Short Selling

Concept

Short Selling means selling shares without owning it. In other words, the task of short sellers is to borrow the shares (generally through the clearing corporation of an exchange) and sell them. The borrowed shares which have been sold are bought back when prices are lower. The shares are then returned back to the lender and the excess profit is pocketed by the short seller.

In India, short selling can only takes place on an intra-day basis. As per the SEBI's revised guidelines, both retail and institutional investors can participate in short selling. These transactions are facilitated by the exchanges. So, if one wants to short sell, one has to undertake the transaction through a broker. If the profit is made, then the short seller has to shell out 15% short term Capital Gain tax.

Risk inherent in short selling

In short selling, there is a scope of making huge return. On the flipper side, risk is also high. If you are trading in shares, the losses can be limited to the amount which you have invested. For e.g. if you have purchased 1000 shares at ₹ 10 each, the maximum loss that can be borne is ₹ 10,000.

However, in case of short selling, the amount of loss which an investor can bear is unlimited. The reason is that the price of shares of a given company can rise to any amount. For instance you short 100 shares at ₹ 50 each, but the shares increases to ₹ 70 each. So, you end up losing

₹ 2000 because you cannot bought back the shares until it reaches below ₹ 50. And, short seller has to return the borrowed shares to the lender. Hence, in short selling, there is an inherent risk of losing a heavy amount if the shares prices do not fall as per the expectations.

However, on the positive side, short selling gives much needed liquidity to the market by keeping the valuation of stocks in check. Another advantage of short selling is that the short seller is not required to pay too much at the time of entering into the transaction. So, initially only a small fee to the broker is required to be paid. And, lastly, it is one of the easiest ways to make money in a bear market.

8. INDIAN DEBT MARKET

Debt market is one of the most important components of a financial system. In fact debt market in most of the developed countries is bigger than the equity market. The Indian Debt market has been a Wholesale market. The major participants are basically restricted to some financial institution only. The primary participants are banks.

So, basically debt market is a financial market where buying and selling of securities takes place. The debt market also facilitates efficient allocation of mobilized resources. It also helps in financing the various developmental projects of the government. Further, the fiscal deficit is often financed by the government borrowing from the market by tapping the debt market.

So, in India, most of the times, the debt market is used as a mechanism to finance the development activities of the government.

8.1 Indian debt market can mainly be classified into two categories

(i) Government Securities Market (G-Sec Market): It consists of central and state government securities. It means that, loans are being taken by the central and state government. It is also the most dominant category in the India debt market.

(ii) Bond Market: It consists of Financial Institution bonds, corporate bonds and debentures and Public Sector Unit bonds. These bonds are issued to meet financial requirements at a fixed cost and hence remove uncertainty in financial costs.

Structurally, the debt market remains firmly skewed towards government securities (G-secs). And the corporate bond market remains largely about top-rated financial and public sector issuances. The good part is, the domestic corporate bond market has done fairly well, fuelled by higher demand as a larger share of financial savings get channeled into the capital market, and favourable supply conditions have emerged because of mounting pressure of non-performing assets (NPAs) at banks.

If India is to see rapid economic growth over the long term – which is an absolute social necessity – the corporate bond market will have to play a pivotal role as a funding source.

Over the five fiscals through 2023, CRISIL expects corporate bond outstanding to more than double to ₹ 55-60 lakh crore, compared with ₹ 27 lakh crore at the end of fiscal 2018, driven by large infrastructure investment requirements, growth of non-banking financial institutions, regulatory push, and the inability of banks to crank up corporate lending because of capital constraints.

However, demand is expected to be only for ₹ 52-56 lakh crore, driven by higher penetration of mutual funds (MFs) and insurance products, increasing retirement subscriptions, growth in corporate investments, and increasing wealth of high networth individuals (HNIs). As a result, there would be a substantial gap of ₹ 3-4 lakh crore between demand and supply of corporate bonds in the next five fiscals. *[Source: Crisil Year Book on the Indian Debt Market 2018]*

Further, a comparative figure of outstanding amount of various types of fixed income securities as on March 31, 2018 has been given as follows:

Outstanding amount of various fixed – income securities

Type of Security	Amount outstanding as on March 31, 2018 (₹ Crore)
Corporate Bonds	2,742,259
Government Securities	5,323,090
SDLs	2,430,333
T – Bills	385,283
CDs	185,732
CPs	372,577
Total	11,439,276

Source: RBI, SEBI, CCIL

The secondary debt market in India can be broadly categorized into –

(a) *Wholesale Debt Market* – comprising of investors like Banks, financial institutions, RBI, insurance companies, Mutual funds, corporates and FIIs.

(b) *Retail Debt Market* – comprising of investors like individuals, pension funds, private trusts, NBFCs and other legal entities.

8.2 Benefits of an efficient Debt Market to the financial system and the economy

- The debt market allows government to raise money to finance the development activities of the government.
- It plays an important role in efficient mobilization and allocation of resources in the economy.

- The Government securities are issued to meet the short term and long term financial needs of the government, they are not only used as instruments for raising debt, but have emerged as key instruments for internal debt management, monetary management and short term liquidity management.
- The debt market also provides greater funding avenues to public-sector and private sector projects and reduces the pressure on institutional financing.
- It also enhances mobilization of resources by unlocking illiquid retail investments like gold.
- Reduction in the borrowing cost of the Government and enable mobilization of resources at a reasonable cost.
- Development of heterogeneity of market participants.
- Assist in development of a reliable yield curve and the term structure of interest rates.

[Source: BSE - FAQs on Debt Market]

8.3 Different types of risks with regard to debt securities

- **Default Risk:** This can be defined as the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security or to otherwise comply with the provisions of a bond indenture and is also referred to as credit risk.
- **Interest Rate Risk:** can be defined as the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments. A good case would be an upswing in the prevailing interest rate scenario leading to a situation where the investors' money is locked at lower rates whereas if he had waited and invested in the changed interest rate scenario, he would have earned more.
- **Reinvestment Rate Risk:** can be defined as the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market.

The following are the risks associated with trading in debt securities:

- **Counter Party Risk:** is the normal risk associated with any transaction and refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale-value at the time of settlement.
- **Price Risk:** refers to the possibility of not being able to receive the expected price on any order due to an adverse movement in the prices. *[Source: BSE - FAQs on Debt Market]*

CHAPTER 5

MONEY MARKET

LEARNING OUTCOMES

After going through the chapter student shall be able to understand :

- **Basics of Money Market**
- **Money Market Participants (Institutions)**
  - (i) Reserve Bank of India (RBI)
  - (ii) Schedule Commercial Banks (SCBs)
  - (iii) Co-operative Banks
  - (iv) Financial and Investment Institutions
  - (v) Corporates
  - (vi) Mutual Funds
  - (vii) Discount and Finance House of India
- **Money Market Instruments**
  - (a) Call/Notice money
  - (b) Treasury Bills (TBs)
  - (c) Commercial Bills
  - (d) Certificate of Deposits (CDs)
  - (e) Commercial Paper

- **CRR, SLR**
- **Determination of Interest Rates**
  (I) MIBOR
  (II) LIBOR
- **Government Securities Market**
- **Recent Development in Money Market**
  (i) Debt Securitization
  (ii) Money Market Mutual Funds (MMMFs)
- **Repurchase Options (Repo.), Reverse Repurchase Agreement (Reverse Repo) and Ready Forward (RF) Contracts**

1. BASICS OF MONEY MARKET

The financial system of any country is a conglomeration of sub-market, viz. money, capital and forex markets. The flow of funds in these markets is multi-directional depending upon liquidity, risk profile, yield pattern, interest rate differential or arbitrage opportunities, regulatory restrictions, etc. The role of money market in the overall financial system is prime in as much as the market acts as a mechanism for ironing out short term surpluses and deficits and provides a focal point for Central Bank's intervention to bring out variations in liquidity profile in the economy. Money Market is the market for short-term funds, generally ranging from overnight to a year. It helps in meeting the short-term and very short-term requirements of banks, financial institutions, firms, companies and also the Government. On the other hand, the surplus funds for short periods, with the individuals and other savers, are mobilised through the market and made available to the aforesaid entities for utilisation by them. Thus, the money market provides a mechanism for ironing out short-term liquidity imbalances within an economy. Hence, the presence of an active and vibrant money market is an essential pre-requisite for growth and development of an economy.

As the Indian economy gets integrated with the global economy, the demand for borrowing and lending options for the corporates and the financial institutions increases everyday. The major players in the money market are the Reserve Bank of India and financial institutions like the UTI, GIC, and LIC.

While the call money rates have been deregulated and left to the demand and supply forces of the market, the RBI intervenes in the repos through its subsidiaries. The RBI also acts in the foreign exchange market, where it sells US dollars to stabilise the rupee-dollar exchange rate.

1.1 Discussion Points

In context of Money Market we shall attempt to answer following questions in this chapter and elsewhere in this Book.

- What is money market?
- Who are the participants?
- What are the instruments used?
- How are the interest rates determined?
- What is call money?
- What is meant by the term *repos*?
- What are the money market mutual funds (MMMFs)?

1.2 Conceptual Framework

The money market is a market for short-term financial assets which can be turned over quickly at low cost. It provides an avenue for equilibrating the short-term surplus funds of lenders and the requirements of borrowers. It, thus, provides a reasonable access to the users of short term money to meet their requirements at realistic prices. Short term financial asset in this context may be construed as any financial asset which can be quickly converted into money with minimum transaction cost within a period of one year and are termed as close substitute for money or near money.

The money market thus may be defined as a centre in which financial institutions congregate for the purpose of dealing impersonally in monetary assets. In a wider spectrum, a money market can be defined as a market for short-term money and financial assets that are near substitutes for money. The term short-term means generally a period upto one year and near substitutes to money is used to denote any financial asset which can be quickly converted into money with minimum transaction cost.

This is a market for borrowing and lending *short-term* funds. Banks, financial institutions, investment institutions, and corporates attempt to manage the mismatch between inflow and outflow of funds by lending in or borrowing from the money market.

1.3 The Distinct Features of Money Market

(i) The money market is a collection of various sub-markets, such as, call money, notice money, repo's, term money, treasury bills, commercial bills, certificate of deposits, commercial papers, etc. and is concerned to deal in particular type of assets, the chief characteristic is its relative liquidity. All the sub-markets have close inter-relationship and free movement of funds from one sub-market to another. There has to be a network of large number of participants which will add greater depth to the market.

(ii) The activities in the money market tend to concentrate in some center which serves as a region or an area; the width of such area may vary considerably in some markets like London and New York which have become world financial centres. Where more than one market exists in a country, with screen-based trading and revolutions in information technology, such markets have rapidly becoming integrated into a national market. In India, Mumbai is emerging as a national market for money market instruments.

(iii) The relationship that characterises a money market should be impersonal in character so that competition will be relatively pure.

(iv) In a true money market, price differentials for assets of similar type (counterparty, maturity and liquidity) will tend to be eliminated by the interplay of demand and supply. Even for similar types of assets, some differential will no doubt continue to exist at any given point of time which gives scope for arbitrage.

(v) Due to greater flexibility in the regulatory framework, there are constant endeavours for introducing new instruments/innovative dealing techniques; and

(vi) It is a wholesale market and the volume of funds or financial assets traded in the market are very large.

(vii) The Indian money market has a dichotomic structure. It has a simultaneous existence of both the organized money market as well as unorganised money markets. The organised money market consists of RBI, all scheduled commercial banks and other recognised financial institutions. However, the unorganised part of the money market comprises domestic money lenders, indigenous bankers, traders, etc. The organised money market is in full control of the RBI. However, unorganised money market remains outside the RBI control.

(viii) The demand for money in Indian money market is of a seasonal nature. India being an agriculture predominant economy, the demand for money is generated from the agricultural operations. During the busy season i.e. between October and April more agricultural activities takes place leading to a higher demand for money.

(ix) In the Indian money market, the organized bill market is not prevalent. Though the RBI tried to introduce the Bill Market Scheme (1952) and then New Bill Market Scheme in 1970, still there is no properly organized bill market in India.

(x) In our money market the supply of various instruments such as the Treasury Bills, Commercial Bills, Certificate of Deposits, Commercial Papers, etc. is very limited. In order to meet the varied requirements of borrowers and lenders, it is necessary to develop numerous instruments.

1.4 Pre–Conditions for an Efficient Money Market

A well-developed money market has following characteristics–

(a) uses a broad range of financial instruments (treasury bills, bills of exchange etc).

(b) channelises savings into productive investments (like working capital),

(c) promote financial mobility in the form of inter sectoral flows of funds and

(d) facilitate the implementation of monetary policy by way of open market operations.

However, the development of money market into a sophisticated market depends upon certain critical conditions. They are:

(i) Institutional development, relative political stability and a reasonably well-developed banking and financial system.

(ii) Unlike capital market or commodity markets, tradings in money market are concluded over telephone followed by written confirmation from the contracting parties. Hence, integrity is sine qua non. Thus banks and other players in the market may have to be licensed and effectively supervised by regulators.

(iii) The market should be able to provide an investment outlet for any temporary surplus funds that may be available. Thus, there must be supply of temporarily idle cash that is seeking short-term investment in an earning asset. There must also exist a demand for temporarily available cash either by banks or financial institutions for the purpose of adjusting their liquidity position and finance the carrying of the relevant assets in their balance sheets.

(iv) Efficient payment systems for clearing and settlement of transactions. The introduction of Electronic Funds Transfer (EFT), Depository System, Delivery versus Payment (DVP), High Value Inter-bank Payment System, etc. are essential pre-requisites for ensuring a risk free and transparent payment and settlement system.

(v) Government/Central Bank intervention to moderate liquidity profile.

(vi) Strong Central Bank to ensure credibility in the system and to supervise the players in the market.

(vii) The market should have varied instruments with distinctive maturity and risk profiles to meet the varied appetite of the players in the market. Multiple instruments add strength and depth to the market; and

(viii) Market should be integrated with the rest of the markets in the financial system to ensure perfect equilibrium. The funds should move from one segment of the market to another for exploiting the advantages of arbitrage opportunities.

(ix) In India, as many banks keep large funds for liquidity purpose, the use of the commercial bills is very limited. RBI should encourage banks to make use of commercial papers instead of making transactions in cash.

The money market in India has been undergoing rapid transformation in the recent years in the wake of deregulation process initiated by Government of India/Reserve Bank of India. The institutions of Primary Dealers (PDs) and Satellite Dealers have been set up as specialised institutions to facilitate active secondary market for money market instruments. New money market instruments have been introduced and more institutions have been permitted as players in the market. Interest rates in respect of all money market instruments have been completely freed and are allowed to be fixed in terms of market forces of demand and supply.

1.5 Rigidities in the Indian Money Market

Notwithstanding the deregulation process initiated by the Reserve Bank of India and several innovations, the money market is not free from certain rigidities which are hampering the growth of the market. The most important rigidities in the Indian money market are:

(i) **Markets are not integrated:** Money market in India is not well integrated. There is a well-developed secondary capital market in India, which does not exist in money market.

(ii) **Players restricted:** Only Government, banks, FII and big companies are involved in the money market. Retail investors are rarely interested in the money market making it restricted to only corporates, the Government and the foreign Institutional Investors (FII's).

(iii) **Supply based-sources influence uses:** Banks are generally the main sources of fund in the money market. Commercial Banks are main supplier of funds in Money Market Instruments especially RBI which issues Treasury Bills on behalf of the Government of India.

(iv) **Not many instruments:** Unlike European Market, only few money market instruments are available in India i.e. Treasury bill, commercial papers, commercial bill, certificate of deposit and call/notice money in India.

(v) **Reserve requirements:** There are fixed reserve requirements in case of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) which banks have to maintain at all times. CRR is the reserve which banks have to keep with RBI. Whereas, SLR is the reserve which banks have to keep with themselves, thus, restricting the flow of money market instruments.

(vi) **Lack of transparency**: There is lack of transparency in money market because the secondary market is not very well developed. Since, the transactions are done Over the Counter (OTC), there is lack of transparency and public information.

(vii) **Commercial transactions are mainly in cash:** Since most of the transactions are done through cash, the circulation of funds in money market instrument is restricted.

(viii) **Heavy Stamp duty limiting use of exchange bills:** In case of issuance of commercial bills, stamp duty is paid in case of bill of exchange, thus, limiting their use. Further, in case of

Commercial Paper (CP), the stamp duty rates applicable to non-bank entities are five times higher than those applicable to banks. Moreover, a CP attracts a stamp duty for 90 days irrespective of the tenure. Hence, CP issued for a shorter period attracts higher stamp duty, making it an expensive financial instrument.

1.6 Distinction between Capital and Money Market

There is, however, basically a difference between the money market and capital market. The operations in money market are for a duration upto one year and deals in short term financial assets whereas in capital market operations are for a longer period beyond one year and therefore, deal in medium and long term financial assets. Secondly, the money market is not a well defined place like the capital market where business is done at a defined place viz. stock exchange. The transactions in the money market are done through electronic media and other written documents. The major points of distinction are enumerated as follows.

(1) In the Capital Market, there is classification between Primary Market and Secondary Market. However, there is no such sub-division in money market, as such. However, slowly a secondary market in greater form is coming up in Money Market also.

(2) Capital Market deals with funding of long term financial requirements. In contrast, the Money Market generally supply fund for short term financial requirements.

(3) If the volume of business of Capital Market is considered (both Primary and Secondary Markets), it will lag behind the total value of transactions in Money Market.

(4) While the number of instruments dealt with in the Money Market are many like

    (a) Interbank Call Money,

    (b) Notice Money upto 14 days

    (c) Short-term deposits upto 3 months

    (d) 91-days Treasury Bill

    (e) 182-days Treasury Bill

    (f) Commercial Paper etc.

    The number of instruments in Capital Market are limited i.e. Shares and Debentures.

(5) The players in Capital Market are general investors, brokers, Merchant Bankers, Registrar to the issue, underwriters, Corporate Investors, Foreign Financial Institutions (FII) and Bankers. While in money market, the participants are Bankers, RBI and Government.

(6) Rate of interest in money market is controlled by RBI or central bank of any country. But capital market's interest and dividend rate depends on demand and supply of securities and stock market's sensex conditions. The regulation of stock market is in the hands of SEBI.

(7) The degree of risk is small in money market. The risk is much greater in capital market. The maturity of one year or less gives little time for a default to occur, so the risk is minimised. Risk varies both in degree and nature throughout the capital market.

(8) The money market is closely and directly linked with central bank of the country. The capital market feels central bank's influence, but mainly indirectly and through the money market.

Distinction between Money Market and Capital Market

Basis	Money Market	Capital Maket
1. Maturity of Instruments	1 year or less	More than 1 year
2. Risks	Less	More and varied
3. Instruments	Treasury bills, CDs, etc	Shares, bonds, etc
4. Finance	Short term	Long term
5. Relation with Central Bank	Direct	Indirect

1.7 The Participants

The money market in India, as many other less developed countries, is characterized by two segments -

1. Organised Segment
2. Unorganised Segment

The principal intermediaries in the organised segment are:

(a) The commercial and other banks,

(b) Non-banking finance companies and

(c) Co-operative societies.

The primary activity of these intermediaries is to accept deposits from the public and lend them on a short-term basis to industrial and trading organisations. In recent years, they have extended their activities to rural areas to support agricultural operations. There is also an active inter-bank loan market as part of the organised money market.

The salient features of the organised money market in India are:

(i) A significant part if its operations which is dominated by commercial banks, is subject to tight control by the Reserve Bank of India which -

(a) regulates the interest rate structure (on deposits as well as loans), reserve requirements and sectoral allocation of credit and

(b) provides support to the banks by lending them on a short-term basis and insuring the deposits made by the public.

(ii) It is characterised by fairly rigid and complex rules which may prevent it from meeting the needs of some borrowers even though funds may be available.

(iii) Overall, there is a paucity of loanable funds, mainly because of the low rate of interest paid on deposits.

The principal participants in the unorganised money market are:

(a) Money Lenders,

(b) Indigeneous Bankers,

(c) Nidhis (mutual loan associations) and

(d) Chit Funds.

They lend, primarily to borrowers who are not able to get credit from the organised money market.

The characteristics of the unorganised money market are:

(i) informal procedures,

(ii) flexible terms,

(iii) attractive rates of interest to depositors and

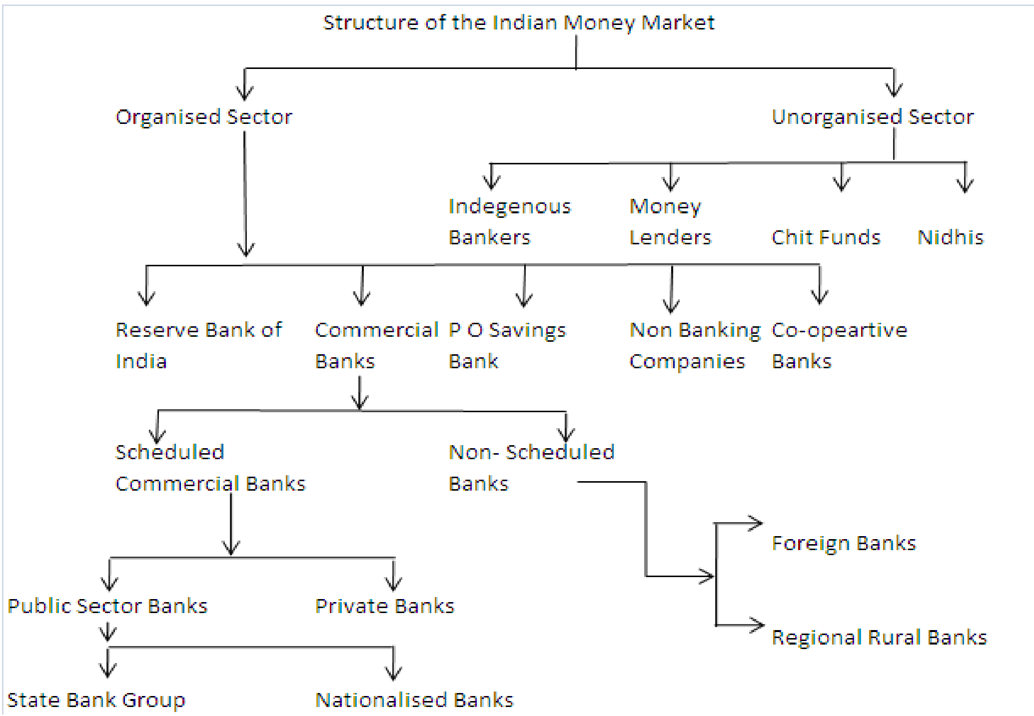
(iv) high rates of interest to borrowers.

The size of the unorganised money market is difficult to estimate, though it appears to be fairly large. However, its importance relative to that of the organised money market is declining. This is a welcome development from the point of view of the Reserve Bank of India because the existence of a large unorganised market frustrates its efforts to control credit.

Access to call money market was restricted to scheduled commercial banks until 1971 when the RBI permitted the Unit Trust of India (UTI) and the Life Insurance Corporation of India (LIC) to deploy their short-term funds. The list was later expanded to include cooperative banks, term-lending financial institutions (such as IDBI, IFCI, ICICI and SCICI), MFs launched by the public sector banks and investment institutions, and the MFs set up in private sector. The RBI allowed the MMMFs set up in the public and private sectors to participate in the money market. Former finance minister agreed in principle to allow the Department of Posts to invest its short-term funds in the call money market.

While banks and the UTI can lend as well as borrow, financial institutions, General Insurance Corporation (GIC), LIC, MFs, and MMMs can only lend in the call money market. The private sector banks and MFs have been demanding a level playing field vis-a-vis the UTI regarding the facility to borrow from the money market so as to meet their redemption requirements. This facility comes in handy for them, particularly in a declining market, as they can obtain the required short-term funds at a lower cost. This is because of the large difference between the cost of the short-term funds in the organised money market and that in the unorganised, or informal, money market. The participation of LIC, GIC and UTI would increase the availability of short-term funds and enable UTI to meet any large repurchases from unit-holders. MFs have now been permitted to borrow from the money market to meet their dividend, interest and redemption obligations.

MMMFs provide an ideal vehicle for an average investor to reap the benefits of high call money rates and high yields on money market instruments which, hitherto, have been enjoyed only by banks and financial institutions while paying a lower rate of interest on deposits. This is because retail investors can't invest in money market instruments due to the restrictions in terms of eligibility and the minimum amount of investment despite higher return offered by these securities. Although, recently, even retail investors have been allowed to subscribe Govt. Securities.



2. MONEY MARKET PARTICIPANTS (INSTITUTIONS)

The important institutions operating in money market are:

(i) Reserve Bank of India (RBI): RBI is the most important participant of money market which takes requisite measures to implement monetary policy of the country. As the Central bank, RBI regulates the money market in India and injects liquidity in the banking system, when it is deficient or contracts the same in opposite situation.

(ii) Scheduled Commercial Banks (SCBs): SCBs form the nucleus of money market. They are the most important borrower/supplier of short term funds. They mobilise the savings of the people through acceptance of deposits and lend it to business houses for their short-term working capital requirements. While a portion of these deposits is invested in medium and long-term Government securities and corporate shares and bonds, they provide short-term funds to the Government by investing in the Treasury Bills.

(iii) Co-operative Banks: Function similarly as the commercial banks.

(iv) Financial and Investment Institutions: These institutions (e.g. LIC, UTI, GIC, Development Banks etc.) have been allowed to participate in the call money market as lenders only.

(v) Corporates: Companies create demand for funds from the banking system. They raise short-term funds directly from the money market by issuing commercial paper. Moreover, they accept public deposits and also indulge in inter-corporate deposits and investments.

(vi) Mutual Funds: Mutual funds also invest their surplus funds in various money market instruments for short periods. They are also permitted to participate in the Call Money Market. Money Market Mutual Funds have been set up specifically for the purpose of mobilisation of short-term funds for investment in money market instruments.

(vii) Discount and Finance House of India: The Discount and Finance House of India Limited (DFHI) has been set up by the Reserve Bank of India jointly with public sector banks and all–India financial institutions to deal in short-term money market instruments. It started operations in April, 1988. At present DFHI participates in the inter-bank call/notice money market and term deposit market, both as lender and borrower. It also rediscounts 182 Days Treasury Bills, commercial bills, CDs and CPs.

3. MONEY MARKET INSTRUMENTS

The money market in India is an important source of finance to industry, trade, commerce and the government sector for both national and international trade through bills–treasury/commercial, commercial papers and other financial instruments and provides an opportunity to the banks to deploy their surplus funds so as to reduce their cost of liquidity. The money market also provides leverage to the Reserve Bank of India to effectively implement and monitor its monetary policy.

The instruments of money market are characterised by

(a) short duration,

(b) large volume

(c) de–regulated interest rates.

(d) The instruments are highly liquid.

(e) They are safe investments owing to issuers inherent financial strength.

The traditional short-term money market instruments consist of mainly call money and notice money with limited players, treasury bills and commercial bills. The new money market instruments were introduced giving a wider choice to short term holders of money to reap yield on funds even for a day or two to earn a little more by parking funds through instruments for a few days more or until such time till they need it for lending at a higher rate.

The instruments used by above-mentioned players to borrow or lend in the money market, include, *inter-alia*, treasury bills (T-bills), Government of India securities (GOI secs), State government securities, government guaranteed bonds, public sector undertaking (PSU) bonds, commercial paper (CP) and certificates of deposit (CDs). Banks, which require short-term funds, borrow or sell these securities and those having surplus funds would lend or buy the securities. Banks experiencing a temporary rise (fall) in their deposits and hence, a temporary rise (fall) in their statutory liquidity ratio (SLR) obligations, can borrow (lend) SLR securities from those experiencing a temporary fall (rise) in their deposits. Banks invest in T-bills, GOI and State government securities, government-guaranteed bonds and PSU bonds to fulfill their SLR obligations.

The various features of individual instruments of money market are discussed in the following paragraphs:

3.1 Call/Notice money

Call money market, or inter-bank call money market, is a segment of the money market where scheduled commercial banks lend or borrow on call (i.e., overnight) or at short notice (i.e., for periods upto 14 days) to manage the day-to-day surpluses and deficits in their cash-flows.

However, under notice money market, funds are transacted for a period between two days and fourteen days. These day to day surpluses and deficits arise due to the very nature of their operations and the peculiar nature of the portfolios of their assets and liabilities.

(i) ***Location***: The core of the Indian money market structure is the inter-bank call money market which is centralised primarily in Mumbai, but with sub-markets in Delhi, Kolkata, Chennai and Ahmedabad.

(ii) ***Duration:*** The activities in the call money are confined generally to inter-bank business, predominantly on an overnight basis, although a small amount of business, known as notice money was also transacted side by side with call money with a maximum period of 14 days.

(iii) ***Participants***:

a. Those who can both borrow as well as lend in the market are RBI, Commercial Banks, Co-operative banks and Primary Dealers.

b. Non-bank institutions (other than PDs) are not permitted in the call/notice money market.

(iv) ***Features***:

a. Current and expected interest rates on call money are the basic rates to which other money markets and to some extent the Government securities market are anchored.

b. Interest rate in the market is market driven and is highly sensitive to the forces of demand and supply. Within one fortnight, rates are known to have moved very high and may even touch level as low as 0.50% to 1%. Intra-day variations are also quite large. Hence, the participants in the markets are exposed to a high degree of interest rate risk.

The call money rates have been fluctuating widely going upto 70 per cent and dropping to around 3 per cent in the recent past.

For many years, while a set of institutions like State Bank of India, UTI, LIC, GIC, etc. continue to be lenders, some banks which have limited branch network are regular borrowers.

c. Although by no means as pronounced as it was once, the activities in the money market are subjected to fluctuations due to seasonal factors, i.e. busy (November to April) and slack (May to October) seasons.

d. One of the most important factors contributing to volatility in the market is mismatches in assets and liabilities created by the banks. Some banks over-extended themselves by using call money borrowings to finance the build-up of a large portfolio of Government of India securities, other long–term assets and non-food credit. It is this asset-liability mismatch which resulted in a sporadic volatility in the market.

e. Apart from the mismatches in assets and liabilities, the inherent weakness of the bank of reasonably forecast their liquidity position had often pushed some of them to the pool of liquidity overhang or severe liquidity crunch.

f. Large-scale diversion of working capital facilities for lending in the inter-corporate deposit market and investments in other treasury products by blue-chip companies amply testify the malady in the current system of working capital financing and its impact on the call money market. The uneasy calm in the money market is attributed to the corporates hunting for cheaper funds in the Euro Dollar and Indian money markets.

3.2 Treasury Bills (TBs):

Treasury Bills are one of the most popular money market instruments issued by the Reserve Bank of India on behalf of the Government of India. T- Bills are generally issued to ward off short-term mismatches in receipts and expenditure. Therefore, the purpose of issuing Treasury Bills is to tackle short term liquidity problems. Treasury bills are generally issued at discount and redeemed at par. The difference between the issued amount and the redemption amount is the amount of interest which is to be paid to the holder of the treasury bills. Thus, the TBs are short-term promissory notes issued by Government of India at a discount.

More relevant to the money market is the introduction of 14 days, 28 days, 91 days and 364 days TBs on auction basis. In order to provide investors with instruments of varying short-term maturities, Government of India introduced the auction of 14 days TBs since June 1997. Further, with a view to developing TBs market and moving towards market rate of interest on Government securities, the auction of 91 days TBs was first introduced in January, 1993. The amount to be auctioned will be pre-announced and cut off rate of discount and the corresponding issue price will be determined in each auction. The amount and rate of discount is determined on the basis of the bids at the auctions.

While the uniform price auction method is followed in respect of 91 days TBs, the cut off yield of other TBs are determined on the basis of discriminatory price auctions. The non-competitive bids in respect of 14 and 364 days TBs are accepted outside the notified amount. The discretion to accept non-competitive bids fully or partially rest with RBI. The amount to be accepted at the auctions and the cut-off price are decided by the Reserve Bank of India on the basis of its public debt management policy, the conditions in money market and the monetary policy stance.

Although State Government also issued treasury bills until 1950, since then it is only the Central Government that has been selling them. In terms of liquidity, for short term financing, the descending order is cash, call loans, treasury bills and commercial bills. Although the degree of liquidity of treasury bills are greater than trade bills, they are not self liquidating as the genuine trade bills are. T-bills are claim against the government and do not require any grading or further endorsement or acceptance.

Following the abolition of 91 days Tap TBs, 14 days Intermediate TBs was introduced with effect from 1st April, 1997. The 14 days TBs are available on tap. State Governments, foreign, Central Banks and other specialised bodies with whom RBI has an agreement are only allowed to invest in this TBs.

However, at present, the RBI issues Treasury Bills of three maturities i.e. 91 days, 182 days and 364 days.

TBs are issued at discount and their yields can be calculated with the help of the following formula:

$$Y = \left[\frac{F-P}{P}\right] \times \frac{365}{M} \times 100$$

where Y = Yield,

F = Face Value,

P = Issue Price/Purchase Price,

M = Maturity.

3.2.1 Features of T-bills

Some of the prime feature of T-bills is as follows:

(i) Form: 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 dematerialised form.

(ii) Eligibility: TBs can be purchased by any person, firm, company corporate body and institutions. State Government, Non-Government Provident Funds governed by the PF Act, 1925 and Employees Provident Fund and Miscellaneous Provisions Act, 1952 are eligible to participate in the auctions of 14 days and 91 days TBs on a non-competitive basis. Non-competitive bids are accepted at the weighted average price arrived at on the basis of competitive bids accepted at the auctions. TBs are approved securities for the purpose of SLR. While Reserve Bank of India does not participate in the auctions of 14 days and 364 days TBs, it will be at its liberty to participate in the auctions and to buy part or the whole of the amount notified in respect of 91 days TBs.

(iii) Minimum Amount of Bids: TBs are issued in lots of ₹ 25,000.

(iv) Repayment: The treasury bills are repaid at par on the expiry of their tenor at the office of the Reserve Bank of India, Mumbai.

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

(vi) Day Count: For treasury bills the day count is taken as 364 days for a year.

3.2.2 Additional Features

T- Bills have the following additional features:

(1) Government's contribution to the money market,

(2) Mop-up short-term funds in the money market,

(3) Sold through auctions,

(4) Discount rate is market driven, and

(5) Focal Point for monetary policy

(6) Helps to meet the temporary mismatches in cash flows

3.2.3 Advantages to Investors

Following are main advantages of T-bills

(i) Manage cash position with minimum balances,

(ii) Increased liquidity,

(iii) Absence of risk of default

(iv) Market related assured yield,

(v) Eligible for repos,

(vi) SLR security,

(vii) No capital loss,

(viii) Two-way quotes by DFHI/Primary Dealers (PDs)/Banks.

(ix) Low transaction cost

(x) No tax deducted at source

(xi) Transparency

(xii) Simplified Settlement

(xiii) High degree of tradability and active secondary market facilitates meeting unplanned fund requirements.

The PDs have assumed the role of market makers in treasury bills and they regularly provide two-way quotes. This has added to the liquidity and deepened the secondary market of this instrument. Thus, treasury bills have emerged as an effective instrument for dynamic asset-liability management. Apart from liquidating the treasury bills in the secondary market, treasury bills can be used for transactions which will help the fund managers to temporarily deploy or borrow funds without altering their assets portfolio. Due to its mode and periodicity of issue (weekly and fortnightly auctions) as also the existence of a well developed secondary market, the fund manager could build-up a portfolio of treasury bills with varying maturities which will match their volatile liabilities.

3.3 Commercial Bills

A commercial bill is one which arises out of a genuine trade transaction, i.e. credit transaction. When the goods are sold, the seller draws a bill of exchange (BOE) on the buyer to pay a certain amount on a particular date. The buyer then accepts the BOE, signs it and sends it to the seller. The seller on the maturity date presents the BOE to the buyer and collects its payment. It is a basically a negotiable instrument and issued for a short period generally ranging from 3 to 6 months.

Bill financing is the core component of meeting working capital needs of corporates in developed countries. Such a mode of financing facilitates an efficient payment system. The commercial bill is instrument drawn by a seller of goods on a buyer of goods. RBI has pioneered its efforts in developing bill culture in India, keeping in mind the distinct advantages of commercial bills, like, self-liquidating in nature, recourse to two parties, knowing exact date transactions, transparency of transactions etc. The RBI introduced Bills Market Scheme (BMS) in 1952 and the Scheme was later modified into New Bills Market Scheme (NBMS) in 1970 on the recommendation of Narasimham Committee. Under the Scheme, commercial banks can discount with approved institutions (i.e. Commercial Banks, Insurance Companies, Development Financial Institutions, Mutual Funds, Primary Dealers, etc.) the bills which were originally discounted by them provided that the bills should have arisen out of genuine commercial trade transactions. The need for physical transfer of bills has been waived and the rediscounting institution can raise Derivative Usance promissory Notes (DUPNs). These DUPNs are sold to investors in convenient lots and maturities on the basis of genuine trade bills, discounted by the discounting bank. The discounting bank should, *inter alia* comply with the following conditions:

(i) Bank which originally discounts the bills only draw DUPN.

(ii) Continue to hold unencumbered usance bills till the date of maturity of DUPN.

(iii) Matured bills should be substituted by fresh eligible bills.

(iv) The transactions underlying the DUPN should be *bona fide* commercial or trade transactions.

The interest rate on re-discounting of bills was deregulated in May, 1989. Notwithstanding various benefits accruing to this mode of financing, bill financing is yet to develop on a scale commensurate with the credit provided by the banks to the commercial sector. The volume of bills finance to total finance is still an insignificant portion. The DUPNs, like commercial bills, are exempted from stamp duty.

Example:

If a bank re-discounted a commercial bill with a face value of ₹ 100/- @ 15% for 2 months will fetch ₹ 97.50, on the basis of the following calculation.

Discount = $100 \times \frac{15}{100} \times \frac{2}{12} =$ ₹ 2.50

However, as the discount amount is paid at front-end.

The yield to the investor or cost to the borrower will be higher than the discount rate in view of the fact that the discounter can deploy the amount of discount received for earning further income. This can be calculated with the following formula:

$$Y = \frac{FV - SV}{SV} \times \frac{\text{Days or months in a year}}{M} \times 100$$

where

Y = Yield

FV = Face Value

SV = Sale Value

M = Period of Discount

Accordingly the Yield as per the data given in the example will be:

$$\frac{100 - 97.50}{97.50} \times \frac{12}{2} \times 100 = 15.385\%$$

3.3.1 Advantages of a developed bill market

A developed bill market is useful to the borrowers, creditors and to financial and monetary system as a whole. The bill market scheme will go a long way to develop the bill market in the country. The following are various advantages of developed bill markets.

(i) Bill finance is better than cash credit. Bills are self-liquidating and the date of repayment of a bank's loans through discounting or rediscounting is certain.

(ii) Bills provide greater liquidity to their holders because they can be shifted to others in the market in case of need for cash.

(iii) A developed bill market is also useful to the banks in case of emergency. In the absence of such a market, the banks in need of cash have to depend either on call money market or on the Reserve Bank's loan window.

(iv) The commercial bill rate is much higher than the Treasury bill rate. Thus, the commercial banks and other financial institutions with short-term surplus funds find in bills an attractive source of both liquidity as well as profit.

(v) A developed bill market is also useful for the borrowers. The bills are time-bound, can be sold in the market and carry the additional security in the form of acceptor's signature. Therefore, for the borrowers, the post of bill finance is lower than that of cash credit.

(vi) A developed bill market makes the monetary system of the country more elastic. Whenever the economy requires more cash, the banks can get the bills rediscounted from the Reserve Bank and thus can increase the money supply.

(vii) Development of the bill market will also make the monetary control measures, as adopted by the Reserve Bank, more effective.

3.4 Certificate of Deposits (CDs)

The CDs are negotiable term-deposits accepted by commercial bank from bulk depositors at market related rates. CDs are usually issued in demat form or as a Usance Promisory Note.

(i) Eligibility: All scheduled banks (except RRBs and Local Area Banks) are eligible to issue CDs. It can be also be issued by select all India Financial Institutions. They can be issued to individuals, corporates, trusts, funds and associations. NRIs can also subscribe to CDs but on non-repatriable basis only. In secondary markets such CDs cannot be endorsed to another NRI.

(ii) Term: The CDs can be issued by scheduled commercial banks (excluding RRBs) at a discount to face value for a period from 7 days to one year.

For CDs issued by Financial institutions maturity is minimum 1 year and maximum 3 years.

(iii) Denomination: The CDs can be issued for minimum amount of ₹ 1 lakhs to a single investor and multiples of ₹ 1 lakh thereafter. There is, however, no limit on the total quantum of funds raised through CDs.

(iv) Transferability: CDs issued in physical form are freely transferable by endorsement and delivery. Procedure of transfer of dematted CDs is similar to any other demat securities. There is no lock in period for the CDs.

(v) Others: The CDs are to be reckoned for reserve requirements and are also subject to stamp duty. Banks are prohibited from granting loans against CDs as buy-back of their own CDs.

(vi) Discount: CDs may be issued at a discount on face value. Banks / FIs are also allowed to issue CDs on floating rate basis provided the methodology of compiling the floating rate is objective, transparent and market-based. The issuing bank / FI is free to determine the discount / coupon rate. The interest rate on floating rate CDs would have to be reset periodically in accordance with a pre-determined formula that indicates the spread over a transparent benchmark. The investor should be clearly informed of the same.

(vii) Reserve Requirements: Banks have to maintain appropriate reserve requirements, i.e., Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), on the issue price of the CDs.

Just like Commercial Bills, Certificate of Deposit (CD) is a front–ended negotiable instrument, issued at a discount and the face value is payable at maturity by the issuing bank.

Example:

Amount of Issue – ₹ 100

Period - 6 months

Rate of discount – 20%

$$\text{Discount} = 100 \times \frac{20}{100} \times \frac{6}{12} = ₹\ 10.00$$

Hence CD will be issued for ₹ 100 – 10 = ₹ 90.00. The effective rate to the bank will, however, be calculated on the basis of the following formula:

$$E = \frac{FV - SV}{SV} \times \frac{\text{Days or months in a year}}{M} \times 100$$

where

E = Effective Yield

FV = Face Value

SV = Sale Value

M = Period of Discount

Accordingly, the Yield as per the data given in the example will be:

$$\frac{100-90}{90} \times \frac{12}{6} \times 100 = 22.226\%$$

In terms of the provisions of CD Scheme, banks were allowed to issue CDs to their customers upto an aggregate amount equivalent to 5 per cent of their aggregate deposit. These instruments are subject to payment of stamp duty like the usance promissory notes. Since a CD is eligible for rediscounting in the money market only after 30 days of holding, the maturity period of CDs available in the market can be anywhere between 1 month to one year. A CD is, therefore, another step in filling the gap between Treasury Bills/Commercial Bills and dated securities. Banks also find this instrument suitable to reward its big size depositors with better rate of return as an incentive.

Despite the large size of the primary market for CDs, there has been virtually no activity in the secondary market and the holders keep the CDs till maturity. So long as there is sluggish growth of deposits at administered low rates vis-a-vis the high rates offered by the non-banking non-financial institutions and others, banks in distress for funds will always need CDs at any cost. They may be useful where the average yield on advances is higher than the effective cost of CDs.

3.5 Commercial Paper

Commercial Paper (CP) has its origin in the financial markets of America and Europe. The concept of CPs was originated in USA in early 19th century when commercial banks monopolised and charged high rate of interest on loans and advances. In India, the CP was introduced in January 1990 on the recommendation of Vaghul Committee subject to various conditions. When the process of financial dis-intermediation started in India in 1990, RBI allowed issue of two instruments, viz., the Commercial Paper (CP) and the Certificate of Deposit (CD) as a part of reform in the financial sector. A notable feature of RBI Credit Policy announced on 16.10.1993 was the liberalisation of terms of issue of CP. At present it provides the cheapest source of funds for corporate sector and has caught the fancy of corporate sector and banks. Its market has picked up considerably in India due to interest rate differentials in the inter-bank and commercial lending rates.

CPs are unsecured and negotiable promissory notes issued by high rated corporate entities to raise short-term funds for meeting working capital requirements directly from the market instead of borrowing from banks. Its period ranges from 7 days to 1 year. CP is generally issued at discount to face value and is transferable by endorsement and delivery. The issue of CP seeks to by pass the intermediary role of the banking system through the process of securitisation.

It partly replaces the working capital limits enjoyed by companies with the commercial banks and there will be no net increase in their borrowing by issue of CP.

3.5.1 Role of RBI

As a regulatory body, RBI lays down the policies and guidelines with regard to commercial paper to maintain a control on the operational aspects of the scheme.

- Prior approval of RBI is required before a company can issue CP in the market.
- RBI controls the broad timing of the issue to ensure orderly fund-raising.
- Every issue of CP launched by a company, including roll-over will be treated as fresh issue and the issuing company will be required to seek prior permission from RBI, before each roll-over.

The CPs can be issued by all non-banking (financial as well as non-financial) companies and All-India Financial Institutions. The instrument is instantly advantageous to the issuer and the investor. The issue of CPs does not involve bulky documentation and its flexibility with the opportunities can be tailored to meet the cash flow of the issuer. A highly rated company can raise cheaper funds than from the financing bank while the investor can deploy its short-term surplus at relatively high return. The secondary market for CPs ensures liquidity and the compulsory credit rating imparts inherent strength to the issuer's ability to meet the obligations on maturity. The bank as managers or dealers of the instrument gets fees to supplement their income. Bank can also invest their surplus short-term funds in CP.

3.5.2 Timing of CP

The timing of the launch of the CP issue would be indicated by RBI while giving its permission, to ensure an orderly approach to the market.

3.5.3 Denomination and size of CP

Denomination of CP note	–	₹5 lacs or multiples thereof.
Maximum size of CP issue	–	100% of the issuer's working capital (fund based) limits (determined by the consortium leader).

The entire approved quantum of CP can be issued on a single date or in parts on different dates, within two weeks of the Reserve Bank of India's approval, subject to the condition that the entire amount of issue matures on the same date.

3.5.4 Period of CP

Minimum currency	–	7 days from the date of issue.
Maximum currency	–	One year from the date of issue.

The entire approved amount should be raised within a period of 2 weeks from the date on which issuer opens the issue for subscription.

Each CP issue (including roll-over) has to be treated as a fresh issue has to seek permission from RBI.

3.5.5 Mode of CP

CP has to be issued at a discount to face value.

Discount rate has to be freely determined by the market.

3.5.6 Negotiability of CP

CP (being usance promissory note) would be freely negotiable by endorsement and delivery.

3.5.7 Underwriting/co-acceptance of CPs

The CP issue cannot be underwritten or co-accepted in any manner. Commercial Banks, however, can provide standby facility for redemption of CPs on the maturity date.

3.5.8 Issue expenses

The issue of CP would be subject to payment of stamp duty. All issue expenses such as dealer's fees, issuing and paying agent's fees, rating agency fees, charges levied by banks for providing redemption standby facilities and any other charges connected with the issue of CPs are to be borne by the issuer.

3.5.9 The issuer

The CP issuer can be a Company incorporated under the Companies Act subject to some requirements.

3.5.10 Benefits of Commercial Paper

CPs have been introduced in the Indian market so as to provide a diversified source of funding to the borrowers as well as an additional investment option to the investors. CPs can now be issued as a low cost alternative to bank financing to meet a part of working capital requirements.

(A) Benefits to the Issuer – The following are major benefits to issuer of CP

(i) **Low interest expenses:** The interest cost associated with the issuance of CP is normally expected to be less than the cost of bank financing, as among other things, it is related to the inter-corporate money market rate, which in normal times is within the cost of bank finance.

(ii) **Access to short term funding:** CP issuance provides a company with increased access to short term funding sources. By bringing the short term borrower into direct contact with investors, the CP market will, to some extent, disintermediate the established role of banks and pass on the benefit to both issuers and investors.

(iii) **Flexibility and liquidity:** CP affords the issuer increased flexibility and liquidity in matching the exact amount and maturity of its debt to its current working capital requirement.

(iv) **Investor recognition:** The issuance of CP provides the issuer with favourable exposure to major institutional investors as well as wider distribution of its debt.

(v) **Ease and low cost of establishment:** A CP programme can be established with ease at a low cost, once the basic criteria have been satisfied.

(B) Benefits to the Investor – The following are major benefits to investor of CP

(i) **Higher yield:** Higher yields are expected to be generally obtainable on CP than on other short term money market instruments like bank deposits. Investment managers are increasingly looking to match investible excess cash with higher yielding securities as compared to those presently available in the market.

(ii) **Portfolio diversification:** Commercial Paper provides an attractive avenue for short term portfolio diversification.

(iii) **Flexibility:** CPs can be issued for periods ranging from 15 days to less than one year, thereby affording an opportunity to precisely match cash flow requirements.

(iv) **Liquidity:** Liquidity in CP is generally provided by a dealer offering to buy it back from an investor prior to maturity, for which a market quote will be available. The investment in CP will therefore be quite liquid.

Difference between Commercial Bill and Commercial Paper

Commercial Bill	Commercial Paper
Commercial Bill arises from sale transactions. Banks finance commercial bills. Usually the bills consist of an invoice	Commercial paper is an unsecured and discounted promissory note issued to finance the short-term credit needs of large

drawn on the buyer, the documents to title to goods and a bill of exchange. The bills are given to the bank for advancing money against sale of goods. Commercial Bill financing is post sale finance. The Bill of Exchange may be on D/P (document against Payment) or D/A (document against acceptance) terms.	institutional buyers. Banks, corporations and foreign governments commonly use this type of funding.

4. CASH RESERVE RATIO (CRR) AND STATUTORY LIQUIDITY RATIO (SLR)

(i) Cash Reserve Ratio (CRR)

CRR is the amount of reserve which banks have to keep it with Reserve Bank of India (RBI). The current CRR rate is 4%. However, this rate may change from time to time as per the discretion of the RBI. So, CRR is basically a fraction of the total amount of deposits collected from the customers and kept as reserve either in cash or as deposits with the central bank. CRR is prescribed according to the guidelines of the central bank of a country.

The basic purpose is to ensure that banks do not run out of cash to meet the demands of their depositors. CRR is a crucial monetary policy tool and is used for controlling money supply in an economy.

Example :

A depositor deposits ₹ 10000 in a bank. Out of ₹ 10000, the bank keeps ₹ 400 as CRR. This works as a type of contingency fund to ward off any payment crises in future.

(ii) Statutory Liquidity Ratio (SLR)

SLR is the amount of reserve which banks have to keep it with themselves. Apart from Cash Reserve Ratio (CRR), banks have to maintain a certain portion of their deposits in the form of liquid assets like cash, gold and non-mortgaged securities.

Further, Banks which subscribe to Treasury bills, issued by RBI on behalf Government, qualifies their SLR requirements. There is a reporting Friday in which Banks have to report to the RBI every alternate Friday their SLR maintenance. If they fail to make such payments, they have to pay penalties for failing to maintain SLR as mandated. The current SLR is 18.75%. However, this rate may change from time to time as per the discretion of the RBI.

Example :

Government comes out with a tax free bond worth ₹ 5000 crore, which RBI issues on behalf of the government. State bank of India subscribes ₹ 500 crore. This whole amount will qualify as SLR.

5. DETERMINATION OF INTEREST RATES

Call money rates were regulated in the past by the RBI or by a voluntary agreement between the participants through the intermediation of the Indian Banks Association (IBA). The interest rates have been deregulated and left to the market forces of demand for; and supply of, short-term money as part of the financial sector reforms.

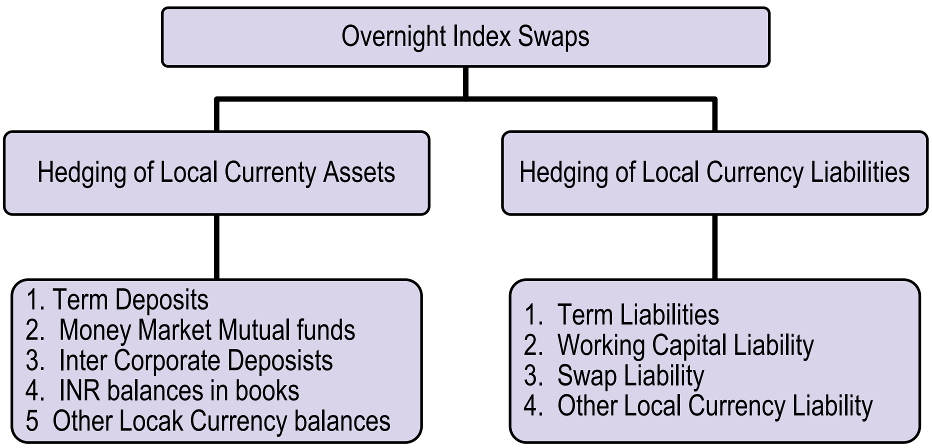
The call money market witnessed turbulence in the recent past when the rates shot up to as high as 130 per cent. The reasons for increase in volatility in the call money market, amongst others, include advance corporate tax payments, investors' interest in primary and secondary capital markets including the units issued by mutual funds, large withdrawals on banks' credit lines, imprudent practices of banks, and developments in the foreign exchange market. Banks were reported to have invested in government securities by borrowing on call to earn the spread when call rates were low.

Issuers, Instruments and Investors in Money Market

Issuer	Instrument	Issuance maturity	Investors
Central Government	GOI secs	2 to 10 years	Banks, LIC, GIC, UTI, FIs, FIIS, MFs, MMMFs, PFs, pension funds, corporates, NBFCs, & RBI
Central Government	T-bills	3 months to 1 year	Banks, UTI, LIC, GIC, PFs, MFs, MMMFs, pension funds, corporates, NBFCs & RBI
State Government	State Government Securities	5 to 10 years	Banks, UTI, LIC, GIC, FIs, PFs, MFs, MMMFs, pension funds, corporates & NBFCs.
Government Agencies	Government Guaranteed Bonds	5 to 10 years	Banks, UTI, LIC, GIC, FIs, PFs, MFs, MMMFs, pension funds, corporates & NBFCs.
PSUs	PSU Bonds	5 to 10 years	Banks, UTI, LIC, GIC, FIs, MFs, MMMFs, NBFCs & corporates
Private sector corporates	Corporate Debentures	1 to 12 years	UTI, other MFs, LIC, GIC, FIs, MMMFs & corporates
Public & Private sector Corporates Banks and FIs	Commercial paper Certificates of deposit	15 days to less than one year 3 months (banks) 1-3 years (FIs)	Banks, MFs, FIs, MMMFs, & corporates Banks, FIs, MFs, MMMFs, & corporates

(i) Money Market – MIBOR (Thomson Reuters)

Overnight Call Money rate in India is published by Reuters and known as "MIBOR''(Mumbai Interbank Offered Rate) . MIBOR stands for overnight Call money rate in India which is getting fixed by Thomson Reuters every day. MIBOR is having an alternate leg which is known as OIS (Overnight Index Swaps). Overnight Index Swaps refers to hedging of local currency in local currency books and in local country which effectively means Hedging of INR denominated Assets/ (Liabilities) by an Indian Corporate in INR books and in India. OIS also means say Hedging of USD denominated Assets/ (Liabilities) by an American Corporate in USD books in NY markets.



(ii) What is 'LIBOR'?

LIBOR i.e. (London Interbank Offered Rate) or ICE LIBOR (previously BBA LIBOR) is a benchmark rate that some of the world's leading banks charge each other for short-term loans. It stands for Intercontinental Exchange London Interbank Offered Rate and serves as the first step to calculating interest rates on various loans throughout the world. LIBOR is administered by the ICE Benchmark Administration (IBA), and is based on five currencies: U.S. dollar (USD), Euro (EUR), pound sterling (GBP), Japanese yen (JPY) and Swiss franc (CHF), and serves seven different maturities: overnight, one week, and 1, 2, 3, 6 and 12 months. There are a total of 35 different LIBOR rates each business day. The most commonly quoted rate is the three-month U.S. dollar rate.

BREAKING DOWN 'LIBOR'

LIBOR (or ICE LIBOR) is the world's most widely-used benchmark for short-term interest rates. It serves as the primary indicator for the average rate at which banks that contribute to the determination of LIBOR may obtain short-term loans in the London interbank market. Currently there are 11 to 18 contributor banks for five major currencies (US$, EUR, GBP, JPY, CHF), giving rates for seven different maturities. A total of 35 rates are posted every business day (number of currencies x number of different maturities) with the 3-month U.S. dollar rate being the most common one (usually referred to as the "current LIBOR rate").

LIBOR or ICE LIBOR's primary function is to serve as the benchmark reference rate for debt instruments, including government and corporate bonds, mortgages, student loans, credit cards; as well as derivatives such as currency and interest swaps, among many other financial products.

For example, take a Swiss franc-denominated Floating-Rate Note (or floater) that pays coupons based on LIBOR plus a margin of 35 basis points (0.35%) annually. In this case, the LIBOR rate used is the one-year LIBOR plus a 35 basis point spread. Every year, the coupon rate is reset in order to match the current Swiss franc one-year LIBOR, plus the predetermined spread.

If, for instance, the one-year LIBOR is 4% at the beginning of the year, the bond will pay 4.35% of its par value at the end of the year. The spread usually increases or decreases depending on the credit worthiness of the institution issuing debt.

Another prominent trait of LIBOR or ICE LIBOR is that it helps to evaluate the current state of the world's banking system as well as to set expectations for future central bank interest rates.

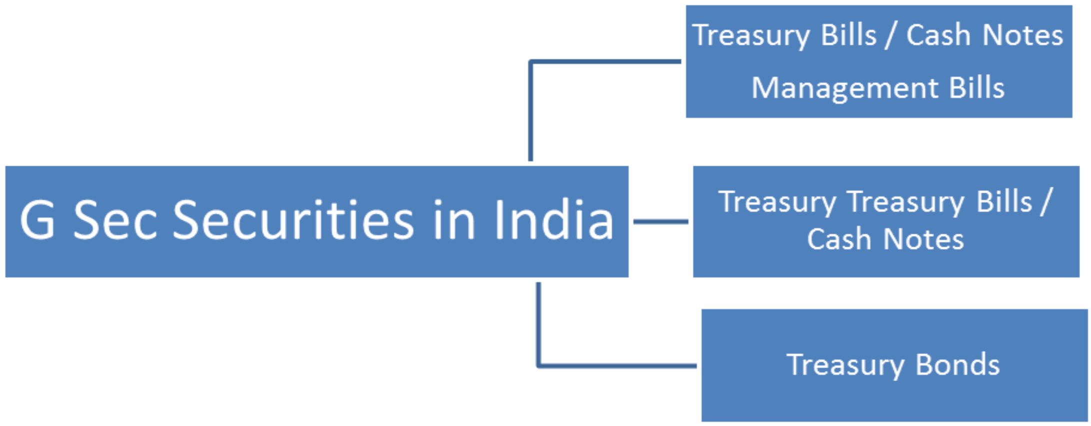
ICE LIBOR was previously known as BBA LIBOR until February 1, 2014, the date on which the ICE Benchmark Administration (IBA) took over the administration of LIBOR. *(Source : Investopedia)*

6. MONEY MARKET INSTRUMENTS: G SEC (GOVERNMENT SECURITIES)

The Reserve Bank of India issues securities on behalf of the Government. The term Government Securities includes Central Government Securities, State Government Securities and Treasury Bills. The different types of Government Securities are –

Dated Securities	**Zero Coupon Bonds or Deep Discount Bonds**	**Floating Rate Bonds**	**Capital Indexed Bonds**
Issued at par value	Issued at discount to face value	Issued at face value	Issued at face value
Interest or coupon rate is fixed at the time of issuances	Do not carry any interest	Interest rate is fixed % over a predetermined floating rate benchmark which may be MIBOR or INBMK curve	Interest Rate is reckoned as a % over Inflation benchmark may be WPI or CPI at the time of issuance.
The tenor of the security is fixed	The tenor of the security is fixed	The tenor of the security is fixed	The tenor of the security is fixed
The security is redeemed at face	The security is redeemed at face	The security is redeemed at face	The security is redeemed at face

value on its maturity date	value on its maturity date plus Zero coupon interest on the security	value on its maturity date	value on its maturity date



7. RECENT DEVELOPMENT IN MONEY MARKET

7.1 Debt Securitization

The buzzword in the money market is now debt securitisation, which refers to converting retail loans into whole sale loan and their reconverting into retail loans. For example, a bank lends ₹ 10 lakhs each to 300 borrowers as part of its loan portfolio. The total debt thus on the books of the bank will be ₹ 30 crores. By way of securitisation, the bank can break the entire portfolio of loans/debt of ₹ 30 crores into a paper of ₹ 300 each for instance, and market it in the secondary market to investors. The philosophy behind the arrangement is that an individual body cannot go on lending sizable amount for about a longer period continuously but if the loan amount is divided in small pieces and made transferable like negotiable instruments in the secondary market, it becomes easy to finance large projects having long gestation period.

The experiment has already been initiated in India by the Housing Development Finance Corporation (HDFC) by selling a part of its loan to the Infrastructure Leasing and Financial Services Ltd. (ILFS) and has therefore become a pacesetter for other kinds of debt securitisation as well.

The Industrial Credit and Investment Corporation of India (ICICI) as well as other private financial companies have been trying similar deals for lease rentals. Some finance companies are also following the same route for financing promoters contribution for projects. The HDFC has entered into an agreement with ILFS to securitise its individual housing loan portfolio to the extent of ₹ 100 crores.

Debt Securitisation will thus provide liquidity to the instrument. As market maker, ILFS will quote a bid and offer a price for the paper. Given the scarcity of resource and to provide flexibility to investors, innovative financing techniques such as debt securitisation which will mobilise additional resources through a wider investor base, is a step in the right direction.

A major trend in the international financial markets in recent years has been towards securitisation of long dated assets, held by them as security/mortgage against credit to customers.

7.2 Money Market Mutual Funds (MMMFs)

One of the recent developments in the sphere of money market is the establishment of Money Market Mutual Funds, the guidelines of which have been made public by the Reserve Bank of India. Money Market Mutual Funds (MMMFs) can be set up by the banks and public financial institutions. There can also be Money Market Deposit Accounts (MMDAs).

(i) Limit: The limit for raising resources under the MMMF scheme should not exceed 2% of the sponsoring bank's fortnightly average aggregate deposits. If the limit is less than ₹ 50 crores for any bank, it may join with some other bank and jointly set up MMMF. In the case of public financial institutions, the limit should not exceed 2% of the long term domestic borrowings as indicated in the latest available audited balance sheets.

(ii) Eligibility: MMMFs are primarily intended for individual investors including NRIs who may invest on a non–repatriable basis. MMMFs would be free to determine the minimum size of the investment by a single investor.

(iii) Minimum rate of return: There is no guaranteed minimum rate of return.

(iv) Lock in period: The minimum lock in period would be 46 days.

(v) Deployment of capital: The resources mobilised by MMMFs should be invested exclusively in various money market instruments.

8. REPURCHASE OPTIONS (REPO.), REVERSE REPURCHASE AGREEMENT (REVERSE REPO) AND READY FORWARD (RF) CONTRACTS

The term Repurchase Agreement (Repo) and Reverse Repurchase Agreement (Reverse Repo) refer to a type of transaction in which money market participant raises funds by selling securities and simultaneously agreeing to repurchase the same after a specified time generally at a specified price, which typically includes interest at an agreed upon rate. Sometimes it is also called *Ready Forward Contract* as it involves funding by selling securities (held on Spot i.e. Ready Basis) and repurchasing them on a forward basis.

8.1 Difference between Repo and Reverse Repo

Following are major differences between Repo and Reverse Repo

(a) Repo rate is the rate at which Reserve Bank of India (RBI) lends to Commercial Banks for a short period of time against Government Securities. On the other hand, Reverse Repo is the rate at which Commercial Banks lend to RBI.

(b) A transaction is called a Repo when viewed from the perspective of the seller of securities (the party acquiring funds) and Reverse Repo when described from the point of view of the supplier of funds. Thus, whether a given agreement is termed a Repo or a Reverse Repo depends largely on which party initiated the transaction.

(c) The purpose of Repo is to fulfill the deficiency of funds. While, the purpose of Reverse repo is to make sure that there is liquidity in the economy.

(d) The Repo rate is comparatively high in comparison to Reverse Repo rate.

(e) The Repo rate strives to contain inflation in the economy. The Reverse repo aims to control money supply in the economy.

(f) Repo is based on Repurchase Agreement i.e. there will be an agreement between two parties on the condition that one party will sell securities to the other on the promise that it will be bought back by him after a certain period of time. On the other hand, Reverse repo is based on the Reverse Repurchase Agreement which is just the opposite of whatever has been explained above.

8.2 Characteristics of Repo

(i) Origin: Repo transactions are of recent origin which has gained tremendous importance due to their short tenure and flexibility to suit both lender and borrower. Under these transactions the borrower places with lender certain acceptable securities against funds received and agrees to reverse this transaction on a pre–determined future date at agreed interest cost.

(ii) Hybrid Instrument: In many respects, Repos are hybrid transactions that combine features of both secured loans and outright purchase and sale transactions but do not fit clearly into their classification.

(iii) Repo rates: The lender or buyer in a Repo is entitled to receive compensation for use of the funds provided to the counterparty. This is accomplished by setting the negotiated repurchase price over the initial sale price, the difference between the two representing the amount of interest or Repo rate owed to the lender. The Repo rate is negotiated by the counterparties independently of the coupon rate or rates of the underlying securities and is influenced by overall money market conditions. In India, Repo rates are determined on the basis of expected call money rates during a reserve mark-up period.

(iv) Period: Repo's are usually arranged with short-term maturity – overnight or a few days. However, the minimum period of Repo in India is fixed at one day.

(v) Interest: The interest on such transactions is market determined and built in the structure of the Repo.

(vi) Eligibility: The transactions can be undertaken by commercial banks, financial institutions, brokers, DFHI.

(vii) Hair Cut: The use of margins or haircuts in valuing repo securities, and the use of mark-to-market provisions are examples of Repo features that typically are characteristics of secured lending arrangements but are rarely found in outright purchase and sale transactions.

(viii) Prohibition: At present Repo transactions have been prohibited in all securities except treasury bills. However, Nand Karni panel set up for examining transactions in PSU bonds and UTI units have recognised the importance of this instrument as a money market instrument and recommended its re–introduction.

8.3 Role of RBI

The RBI intervenes in the market as and when required by conducting repos (ready forward purchases) through its two subsidiaries, namely, Securities Trading Corporation of India (STCI) and Discount and Finance House of India (DFHI). The central bank banned these transactions between banks following their misuse to divert funds from the banks to the stock market and reintroduced the same in April, 1992. The RBI has permitted repos in dated securities, and reverse repo transactions by non–bank subsidiary general ledger (SGL) account holders in the lean season credit policy announced in April, 1997. Non-bank entities holding SGL accounts can lend their surplus money to banks by entering into a reverse repurchase agreement or reverse repo. These entities entering into a reverse repo with banks purchase (permitted) repo securities from banks with a commitment to sell the same at an agreed future date and price.

When there is a spurt in call rates, the RBI intervenes through STCI/DFHI by conducting these repos to inject the required liquidity. STCI and DFHI are market-makers in dated GOI secs and T-bills. They give a two-way quote for the securities which they make the market for. The bid, or the buying rate, is always lower than the ask, or selling rate, for a given security. The spread between bid and ask (or offer) rate accounts for the transaction cost and normal profit from operations. The RBI intervenes to prevent the diversion of investment funds to the call money market.

Example

Bank A, which is short of cash, can sell its repo securities to Bank B or STCI or DFHI at ₹ 96.25 with a commitment to repurchase them at ₹ 96.75 after 14 days. The difference between the sale price and the repurchase price or the spread represents the interest rate on the borrowed money.

The Repo buyer's rights to trade the securities during the term of the agreement, as it represents a transfer of ownership that typically does not occur in collateralised lending arrangements.

The amount of interest earned on funds invested in a Repo determined as follows:

Interest earned = Funds Invested × Repo Rate × Number of Days/365

For example, if ₹ 1 crore is for 3 days @ 5% would yield interest return of ₹ 0.04 lakhs.

1,00,00,000 × 0.05 × 3/365 = ₹ 4110

Illustration

Bank A enters into a Repo for 14 days with Bank B in 12% GOI Bonds 2017 at a rate of 5.25% for ₹5 Crore. Assuming that the clean price is 99.42, initial margin be 2% and days of accrued interest be 292, you are required to determine:

(a) Dirty Price

(b) Start Proceeds (First Leg)

(c) Repayment at Maturity (Second Leg)

Note: Number of days in a year is 360.

Answer

(a) Dirty Price

= Clean Price + Interest Accrued

$$= 99.42 + 100 \times \frac{12}{100} \times \frac{292}{360} = 109.1533$$

(b) First Leg (Start Proceed)

$$= \text{Nominal Value x } \frac{\text{Dirty Price}}{100} \times \frac{100 - \text{Initial Margin}}{100}$$

$$= ₹5,00,00,000 \text{ x } \frac{109.1533}{100} \times \frac{100\text{-}2}{100} = ₹5,34,85,117 \text{ say } ₹5,34,85,000$$

(c) Second Leg (Repayment at Maturity)

$$= \text{Start Proceed x } (1 + \text{Repo rate} \times \frac{\text{No. of days}}{360})$$

$$= ₹5,34,85,000 \text{ x } (1 + 0.0525 \times \frac{14}{360}) = ₹5,35,94,199$$

In India, the repo market in Government securities and PSU bonds became very active in 1980s, and the deals were generally interbank. While certain regulatory restrictions were put in place in 1987, in the aftermath of securities scam, RBI imposed a ban on inter-bank repos in 1992 in all instruments except TBs. Since then RBI has made several relaxations in regard to Repo Transactions.

The conditions imposed by RBI in regard to repo transactions are:

(i) The banks should enter into Repo transactions only in respect of TBs of all maturities, notified Government of India dated securities, and private corporate bonds/PSU bonds which are in demateralised form and the transactions are done in recognised Stock Exchanges;

(ii) Repo transactions should be entered only with commercial and co-operative banks and Primary Dealers. However, non-bank entities who are holders of SGL Account with RBI can enter into Reverse Repo transactions with banks/Primary Dealers in TBs, notified Government of India stocks, debentures/PSU bonds:

(iii) The purchase/sale price should be in alignment with the ongoing market rates;

(iv) No sale of securities should be affected unless such securities are actually held by them in their own investment portfolio;

(v) Immediately on sale, the corresponding amount should invariably be deducted from the investment account of the banks;

(vi) The minimum period of the Repo should be one day; and

(vii) The securities under Repo should be marked to market on the balance sheet date.

DFHI/STCI/PDS are very active in Repo market and the volume of such transactions has shown substantial increase when the call money rates move up beyond a particular level. Of late, RBI has been conducting Repo auctions for 3/4 days to mop-up the excess liquidity released to the system through reduction of CRR/Intervention in the forex market.

Repo transactions are structured to suit the requirements of both the borrowers and the lender of funds and have become extremely popular mode of raising/investing short-term funds. Further, a SLR surplus and CRR deficit bank can use the repo deals as a convenient way of adjusting SLR/CRR positions simultaneously. The Repo is a convenient instrument for Asset-Liability management.

"Non-banking institutions like corporates, mutual funds and financial institutions can go to repo (repurchase) market for meeting their short-term funds or securities requirement".

Of late the Reserve Bank has been making efforts to develop the repo market in the country. It has initiated a series of measures to popularize and widen the participation in the repo market.

The measures include:

- permission to non-bank participants to undertake repo and reverse repo transactions,
- reduction in the minimum maturity for repo transactions to one day and offering even State government securities for undertaking repos.

The repo (repurchase) market is mainly a buyback arrangement.

Under such an arrangement the seller sells specified securities with an agreement to repurchase the same at a mutually decided future date and a price.

Similarly, the buyer purchases the securities with an agreement to resell the same to the seller on an agreed date in future at a prefixed price.

This is done mainly to bridge the short-term gap of either cash flow or securities (to meet SLR — statutory liquidity ratio — requirements).

9. DAY COUNT CONVENTION

Day Count Convention defines the way in which interest accrues over time. Generally, we know the interest is earned for some reference period, (for example, the time between coupon payments), and we are interested in calculating the interest earned over some other period.

In other words, Day count convention specifies the number of days that a year contains according to the bond market. The number of days in a year is important for the calculation of the interest that has been accrued on the bond. However, the day count convention is not followed uniformly around the world. The trader in the Bond Market must have the knowledge of the type of convention being used in a particular market as each market follows its own convention. Further, day count conventions can be segregated into three components:

- The year is assumed to be composed of 360 days
- The year is assumed to be composed of 365 days
- The year is assumed to be composed of the actual number of days i.e. 365 or 366 in a leap year

So, Day Count Convention refers to the method used for arriving at the holding period (number of days) of an instrument to calculate the accrued interest. The various types of day count conventions are explained as follows:

- **30/360** convention means that irrespective of the actual number of days in a month, the number of days in a month is taken as 30 and the number of days in a year is taken as 360. Indian Bond Market, mortgage-backed securities use the 30/360-day count convention
- **Actual/365** uses the actual number of days in a month, whereas the number of days in a year is taken as 365 days. Indian Money Market instruments use this convention. For example, Treasury bond or G- Sec bonds etc.
- **Actual/Actual** convention uses the actual number of days in the month and the actual number of days in the year, i.e. 366 days for a leap year. Indian corporate bonds use Actual/Actual day count convention
- **Actual/360** counts the actual number of days in a month, but uses 360 as the number of days in the year. This convention is used mainly for commercial paper, T – Bills and other short term debt instrument.

The day count convention method has been illustrated below with the help of following example:

	Day Count Convention			
Field	30/360	Actual/360	Actual/365	Actual/Actual*
Starting Date	01-May-18	01-May-18	01-May-18	01-May-18
Settlement Date	01-Aug-18	01-Aug-18	01-Aug-18	01-Aug-18
Coupon Rate (%)	10%	10%	10%	10%
Face Value	100	100	100	100
No. of Days	90	92	92	92
Accrued Interest	2.5000	2.5556	2.52055	2.52055

* 2018 is not a leap year so 365 days in a year have been taken for the interest calculation.

SEBI has clarified certain aspects relating to Day Count Convention, which are enumerated as below:

(i) If the interest payment date falls on a holiday, the payment may be made on the following working day however the dates of the future coupon payments would be as per the schedule originally stipulated at the time of issuing the security. In other words, the subsequent coupon schedule would not be disturbed merely because the payment date in respect of one particular coupon payment has been postponed earlier because of it having fallen on a holiday.

This is illustrated with the help of the following example:

Date of Issue of Corporate bonds : July 01, 2016

Date of Maturity : June 30, 2018

Date of coupon payments : January 01 and July 01

Coupon payable : semi-annually

In this case, January 01, 2017 is a Sunday, thus the coupon would be payable on January 02, 2017 i.e. the next working day. However, the calculation for payment of interest will be only till December 31, 2016, which would have been the case if January 01, 2017 were not a holiday. Also, the next dates of payment would remain July 01, 2017 and January 01, 2018 despite the fact that one of the interest payment was made on January 02, 2017.

(ii) In order to ensure consistency for interest calculation, a uniform methodology shall be followed for calculation of interest payments in the case of leap year, which shall be as follows:

In case of a leap year, if February 29 falls during the tenor of a security, then the number of days shall be reckoned as 366 days (Actual/Actual day count convention) for a whole one year period, irrespective of whether the interest is payable annually, half yearly, quarterly or monthly etc. It is thus emphasized that for a half yearly interest payment, 366 days would be reckoned twice as the denominator; for quarterly interest, four times and for monthly interest payment, twelve times.

This is illustrated with the help of the following example:

Date of issue of corporate bonds	: January 01, 2016
Coupon payable	: semi-annually
Date of coupon payments	: July 01 and January 01

In the above example, in case of the leap year (i.e., 2016), 366 days would be reckoned as the denominator (Actual/Actual), for payment of interest, in both the half year periods i.e. Jan 01, 2016 to Jul 01, 2016 and Jul 01, 2016 to Jan 01, 2017.

(iii) In order to ensure uniformity for payment of interest/redemption with respect to debt securities, it has been decided that interest/redemption payments shall be made only on the days when the money market is functioning in Mumbai.

CHAPTER 6

INSTITUTIONS AND INTERMEDIARIES

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Depository
- Stock and Commodity Exchanges – Indian and Global
- Intermediaries
- Institutional Investors
- FPIs
- Custodians
- Clearing Houses

1. DEPOSITORY

Depository in simple terms means a place securities are kept safely. Actually, depository is an organization which keeps securities in electronic form and helps in the transfer of ownership of securities. As per section 2(e) of the Depositories Act, 1996, 'Depository means a company formed and registered under the Companies Act, 2013 and which has been granted a certificate of registration under Securities and Exchange Board of India Act, 1992.'

In the depository system, transactions in securities are done entirely on paperless or electronic basis. This is quite similar to the banking system where one opens an account with a bank. Similarly, in case of depository system, an investor willing to invest in the securities market opens an account (which is called a 'Demat Account') with a depository. Whenever securities are allotted to a particular investor, his account will be credited. In the same way whenever any securities are sold by that particular investor, his demat account will be debited by the amount of shares sold by him. A depository also acts a securities bank where dematerialized securities in electronic are kept in safe custody.

1.1 Benefits of a Depository System

To the Investors

i) It eliminates bad deliveries of securities.

ii) The settlement cycle has become quicker. It is now T + 1.

iii) Immediate transfer and registration of securities are possible now.

iv) It eliminates the risks present in physical certificate for e.g. forgery, delays, mutilation, theft and damage of share certificates.

v) Electronic transfer of securities enables the investor to get dividend, bonus shares and right shares quickly.

vi) Transaction costs are lower as transfer of securities in electronic form is exempt from stamp duty;

vii) Further, as trading in depository system is paperless; no share certificate and share transfer deed is required.

viii) Lastly, rate of interest on loan against the pledged demat shares are lower in comparison to physical shares.

To the Company

i) The depository system helps a company to maintain and update its shareholding pattern periodically. The company has knowledge of the beneficial ownership and their holdings at all times.

ii) The cost of issue of securities also gets lowered because of dematerialisation of securities.

iii) Another advantage of depository system is that large number of transactions can be settled promptly.

(iv) Distribution of dividends and issuance of rights shares and bonus shares will be quicker as the ownership can be easily identified.

v) The transfer process under depository system is quick and without any defects. Therefore, complaints against the company by investors have been drastically reduced in this respect.

To the Capital Market

i) The capital market is more transparent, as trading, clearing and settlement are automatic and always inter linked with the depository.

ii) Use of latest technology in the depository system has made the capital market activities more efficient.

iii) That has made the investors to have more confidence in the capital market.

iv) Use of depository system has attracted foreign institutional investors in large numbers.

v) Use of electronic system has made the Indian Capital Market more flourishing. For instance, we can take the example of mutual funds which have increased substantially in the last few years.

1.2 The Process of Depository System

Four parties are involved in a depository system i.e. the customer, the depository participant (DP), the depository, and the share registrar and transfer agent. The process of the depository system and the involvement of the four parties as mentioned above are discussed as below:

(a) **Account Opening:** An investor who wishes to avail the depository services has to apply for opening an account with a depository through a Depository Participant (DP). A depository participant can either be a custodian, a bank, a broker, or an individual. After opening an account, the investor is allotted a client account number. The holder of a demat account is called a 'beneficial owner'. He has the option of opening more than one demat account either with the same DPs or multiple DPs.

(b) **Dematerialization:** In order to convert physical shares into electronic one, an investor has to make an application to the depository in a Dematerialization Request Form (DRF). DP forwards the form within seven days to the issuer company or its Registrar and Share Transfer Agent (RTA). The company or its RTA, then, verifies the validity of the security certificates and the fact the person making an application is actually a registered member. After verification, the issuer company or its RTA, on being satisfied, authorizes an electronic credit of security in favour of the investor. Thereafter, the depository also credit the demat account of the investor.

(c) **Rematerialisation:** An investor having a demat account can apply for withdrawl of balance in his account in a Rematerialization Request Form (RRF). On receipt of the RRF, if the DP is satisfied that there is sufficient balance, will block the balance of the investor to the extent of the rematerialisation quantity and electronically forwards the request to the depository. The depository will then block the balance of the investor to the extent of the rematerialisation quantity and forward the accepted rematerialisation application to the issuer or its Registrar and Share Transfer Agent (RTA). The RTA will confirm that RRF has been accepted. Then, the RTA will dispatch the physical share certificates within 30 days.

(d) **Distributing Dividend:** A company or its RTA generally informs the depository of various dates such as book closures, redemption or maturity of security etc. This enables the depository to electronically provide to the company a list of the holding of the investors on the day of distribution of dividend. The company will, then, distribute dividend on the basis of the list provided.

(e) **Closing an Account:** If an investor wants to close his account, he shall make an application in the prescribed format to the DP. The DP may close his account if no balances are there in the investor's demat account. If any balances exist, then account may be closed either by rematerialisation or transferring his securities to other account either with the same depository participant or with a different depository participant.

2. STOCK AND COMMODITY EXCHANGES – INDIAN AND GLOBAL

The stock exchanges are meant to facilitate mobilization of resources by companies. However, the regulation of stock exchanges is necessary to protect the interests of investors and safeguarding the role of stock exchanges with regard to the development of the capital market.

Stock exchanges are basically regulated by SEBI. The recognition given to a stock exchange to function in the capital market is given by SEBI. The Securities Contracts (Regulation) Act 1956 along with the Securities Contracts (Regulation) Rules 1957 has been the main laws to regulate the securities market in India. As per the Securities Contracts Regulations Act, 1956 a stock exchange is defined as "an association, organization or body of individuals whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities".

2.1 Growth of Stock Exchanges

The history of Stock Exchanges in India goes back to the eighteenth century, when securities of the East India Company were transacted. There were 50-60 brokers led by the legendary Premchand Roychand. They formed the backbone of share floatation by East India Company and a few commercial banks. Corporate shares made their entry in the 1830s and assumed significance with the enactment of the Companies Act in the 1850s. The Bombay Stock Exchange, the oldest stock exchange in India was established in 1875 under the name, Share and Stockbrokers Association.

The stock exchanges are tightly regulated as self-regulatory organizations (SROs) under the Act. In addition to ordinary regulatory powers over the stock exchanges, the Central Government and/or SEBI may nominate up to three members to the board of each stock exchange [Section 4(2) (iii) of the SC (R) Act, 1956 and Section 10 of SC(R) Rules, 1957]. The government and/or the agency have the authority to make, approve and amend the byelaws of the stock exchanges [Section 4(1)(a) & 8 of the SC(R) Act, 1956]. In return, the stock exchanges have been granted a strong disciplinary authority (as well as obligations) over their member stockbrokers.

2.1.1 Leading Stock Exchanges in India

The two leading stock exchanges in India are Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). A brief about them has been discussed as below:

(a) Bombay Stock Exchange Limited: It is the oldest stock exchange in Asia and was established as "The Native Share & Stock Brokers Association" in 1875. The Securities Contract (Regulation) Act, 1956 gives permanent recognition to Bombay Stock Exchange in 1956. BSE became the first stock exchange in India to obtain such permission from the Government under the Act.

The Exchange's pivotal and pre-eminent role in the development of the Indian capital market is widely recognized and its index, *SENSEX*, is tracked worldwide. Earlier, an Association of Persons (AOP), the Exchange is now a demutualized and corporatized entity incorporated under the provisions of the Companies Act, 1956, pursuant to the BSE (Corporatization and Demutualization) Scheme, 2005 notified by the Securities and Exchange Board of India (SEBI).

The Exchange has a nation-wide coverage. The BSE's systems and processes are designed in such a way that it safeguards the integrity of the market and ensure transparency in its operations.

Therefore, the traders can freely trade in equity, debt and derivative instruments as they are pretty much sure of the BSE's transparent and efficient operations. The BSE's On Line Trading System (BOLT) is a proprietary system of the Exchange and is BS 7799-2-2002 certified. Similarly, the surveillance and clearing & settlement functions of the Exchange are ISO 9001:2000 certified.

(b) National Stock Exchange: NSE was incorporated in 1992. It was recognized as a stock exchange by SEBI in April 1993 and commenced operations in 1994 with the launch of the wholesale debt market, followed shortly after by the launch of the cash market segment.

NSE also has strategic investments in complementary businesses, including mutual fund registry services, back-end exchange support services for its platforms, depository services, e-corporate governance and commodity, power and receivables exchanges.

The National Stock Exchange of India Ltd. (NSE) is the leading stock exchange in India and the second largest in the world by number of trades in equity shares from January to June 2018, according to World Federation of Exchanges (WFE) report.

NSE launched electronic screen-based trading in 1994, derivatives trading (in the form of index futures) and internet trading in 2000, which were each the first of its kind in India.

NSE has a fully-integrated business model comprising our exchange listings, trading services, clearing and settlement services, indices, market data feeds, technology solutions and financial education offerings. NSE also oversees compliance by trading and clearing members and listed companies with the rules and regulations of the exchange.

NSE is a pioneer in technology and ensures the reliability and performance of its systems through a culture of innovation and investment in technology. NSE believes that the scale and breadth of its products and services, sustained leadership positions across multiple asset classes in India and globally enable it to be highly reactive to market demands and changes and deliver innovation in both trading and non-trading businesses to provide high-quality data and services to market participants and clients. *[Source: NSE Website]*

2.1.2 Stock Exchanges Abroad

With the increasing globalization and liberalization, the prices of securities on Indian stock exchanges are influenced by stock exchanges abroad. Under this heading we have tried to give a brief introduction of the major stock exchanges abroad.

(a) New York Stock Exchange (NYSE): The New York Stock Exchange was established more than 200 years ago in 1792. NYSE is the world's foremost securities marketplace.

Each day on the NYSE trading floor an auction takes place. Open bid and offers are made by investors which are efficiently managed by exchange members who act on behalf of institutions and individual investors. Prices are determined through the forces of demand and supply. Buy and sell orders given by investors for the listed securities are given an assigned location where a NYSE member from employed broker acts as an auctioneer in an open outcry market. However, from January 24, 2007 onwards NYSE stocks are also being traded electronically.

(b) ***Nasdaq:*** Nasdaq is known for its growth, liquidity, depth of market and the world's most powerful, forward-looking technologies. This makes NASDAQ the leading choice of some of the well-known companies in the world. NASDAQ was born in 1971. Since then, it has outformed the other market to become the fastest growing stock exchange in USA. In Nasdaq, trading takes place in electronic trading platform having the highest level of efficiency.

As Nasdaq is one of the world's most popular stock exchanges, the companies in order to get listed on it must satisfy the most strict earnings, capitalization and corporate governance norms.

In contrast to NYSE, the Nasdaq is a fully electronic trading platform for securities. So, it has no individual specialist broker through which the transactions go through. Nasdaq's market structure is such that it allows large number of participants to undergo trading in stocks though a highly sophisticated computer network. Together, these participants help ensure transparency and liquidity for a company's stock while maintaining an orderly market and functioning under tight regulatory controls.

(c) ***London Stock Exchange*****:** The history of the formation of London stock exchange can be traced back to 1760 when 150 brokers fired from royal Exchange for misbehavior formed a club at Jonathan's Coffee House to buy and sell shares. In 1773, members voted to change the name to Stock Exchange and 2000 shareholders voted it to become a public limited company and thus London Stock Exchange plc was formed. Dealing in shares is conducted via an off-market trading facility operated by Cazenove and Co.

London Stock Exchange provides a range of services for companies and investors:

(i) ***Company Services -*** It provides a number of markets which allow companies large and small to raise capital, and a range of services to increase the profile of the companies.

(ii) ***Trading Services -*** It gives market users access to a well-developed trading environment with a proven record of stability and flexibility.

(iii) ***Information Services -*** It provides high quality real-time price information to market users worldwide, as well as historical and reference data.

Supporting these activities, the exchange regulates the markets to give protection to investors and companies and to maintain its reputation for high standards and integrity. In addition, in partnership with others, it helps to track the performance of the markets through various indices.

2.2 Characteristics of Stock Exchanges in India

Stock exchange is an association of individual members called brokers. It is formed with the aim to regulate and facilitate the buying and selling of securities by retail investors and institutions. Corporate membership of stock exchanges was introduced lately.

A stock exchange is typically governed by a board, consisting of directors. Some Members of the Board are nominated by the Government. Government nominees include representatives of the Ministry of Finance, as well as some public representatives, who are expected to safeguard the interest of investors in the functioning of the exchanges. The board is headed by a President, who is an elected member, usually nominated by the government, from among the elected members. The Executive Director, who is appointed by the stock exchange with government approval, is the operational chief of the stock exchange. His duty is to ensure that the day-to-day operations of the stock exchange are carried out in accordance with the rules and regulations governing its functioning.

Securities and Exchanges Board of India (SEBI) has been set up in Mumbai by the Government to oversee the orderly development of stock exchanges in the country. Every company which wishes to raise capital from the public is required to get its securities listed in atleast one stock exchange. Thus, all ordinary shares, preference shares and debentures of publicly held companies are listed in one or more stock exchanges.

2.3 Functions of Stock Exchanges

The Stock Exchange is a market place where investors buy and sell securities. Functions of the stock exchanges can be summarized as follows:

(a) Liquidity and Marketability of Securities: The basic function of the stock market is the creation of a continuous market for securities, enabling them to be liquidated, where investors can convert their securities into cash at any time at the prevailing market price. It also provides investors the opportunity to change their portfolio as and when they want to change, i.e. they can at any time sell one security and purchase another, thus giving them marketability.

(b) Fair Price Determination: The stock market is almost a perfectly competitive market. The reason is that there are large number of buyers and sellers, near perfect information and active bidding from both the buyer's and the seller's side. The reasons as mentioned above ensures that fair price is determined by the forces of demand and supply.

(c) Source for Long term Funds: Corporates, Government and public bodies raise funds from the equity market. These securities are negotiable and transferable. They are traded and change hands from one investor to the other without affecting the long-term availability of funds to the issuing companies.

(d) Helps in Capital Formation: Savings and investments of the people are closely interrelated. The savings of the community are mobilized and channeled by stock exchanges for investment into those sectors and units which are favoured by the community at large, on the basis of such criteria as good return, appreciation of capital, and so on. It is the preference of investors for individual units as well as industry groups, which is reflected in the share price that decides the mode of investment.

Stock exchanges render this service by arranging for the preliminary distribution of new issues of capital, offered through prospectus, as also offers for sale of existing securities, in an orderly and systematic manner. They themselves administer the same, by ensuring that the various requisites of listing (such as offering at least the prescribed minimum percentage of capital to the public, keeping the subscription list open for a minimum number of days, enlisting prescribed centres for receiving of applications, allotting shares against application received are complied with.

Stock exchanges also provide a forum for trading in rights shares of companies already listed, thereby enabling a new class of investors to take up a part of the rights in the place of existing shareholders who renounce their rights for monetary considerations.

(e) Reflects the General State of Economy: The way stock markets perform is indicative of the manner of economic health of a country i.e. whether the economy is undergoing boom or depression. It indicates the general state of the economy to all those concerned, who can take suitable steps in time. The Government takes suitable monetary and fiscal steps depending upon the state of the economy.

2.4 Indian Commodity Exchanges

Presently four national commodity exchanges are operational; National Multi-Commodity Exchange of India (NMCE), Indian Commodity Exchange (ICEX), National Commodity and Derivatives Exchange (NCDEX) and Multi Commodity Exchange (MCX).

(a) ***National Commodity & Derivatives Exchange Limited (NCDEX):*** NCDEX is a professionally managed online multi commodity exchange. It is promoted by ICICI Bank Limited (ICICI Bank), Life Insurance Corporation of India (LIC), National Bank for Agriculture and Rural Development (NABARD) and National Stock Exchange of India Limited (NSE), Punjab National Bank (PNB), CRISIL Limited (formerly the Credit Rating Information Services of India Limited), Indian Farmers Fertiliser Cooperative Limited (IFFCO), Canara Bank and Goldman Sachs by subscribing to the equity shares of the Exchange. NCDEX is the only commodity exchange in the country promoted by national level institutions.

NCDEX is a public limited company incorporated on April 23, 2003 under the Companies Act, 1956. It commenced its operations on December 15, 2003.

It is a national level, technology driven demutualized on-line commodity exchange with an independent Board of Directors and professionals not having any vested interest in commodity markets. It is committed to provide a world-class commodity exchange platform for market participants to trade in a wide spectrum of commodity derivatives driven by best global practices, professionalism and transparency.

Initially, it was regulated by Forward Market Commission in respect of futures trading in commodities. However, FMC is merged with SEBI in 2015. Now, SEBI is also the regulator of commodity exchanges. Further, NCDEX is also required to comply various laws like the Companies Act, Stamp Act, Contract Act, SEBI Act and various other legislations, which generally hamper it's working.

(b) ***Multi Commodity Exchange (MCX):*** MCX is an independent and demutualized multi commodity exchange. The government has given it permanent recognition for facilitating online trading, clearing and settlement operations for commodities futures market across the country.

Because of the opportunities galore offered by the MCX to a large cross section of participants including producers/ processors, traders, corporate, regional trading centre, importers, exporters, co-operatives and industry associations amongst others, it offers trading in more than 30 commodity futures contracts. The headquarter of MCX is in Mumbai. Further, it is led by an expert management team with good knowledge of the commodities futures market.

Being a nation-wide commodity exchange having state-of-the-art infrastructure, offering multiple commodities for trading with wide reach and penetration, MCX is well placed to tap the vast potential posed by the commodities market.

The key shareholders of MCX are Financial Technologies (I) Ltd. (now, 63 Moons Technologies Limited), State Bank of India and its' associates, National Bank for Agriculture and Rural Development (NABARD), National Stock Exchange of India Ltd. (NSE), Fid Fund (Mauritius) Ltd. - an affiliate of Fidelity International, Corporation Bank, Union Bank of India, Canara Bank, Bank of India, Bank of Baroda, HDFC Bank and SBI Life Insurance Co. Ltd.

(c) ***Indian Commodity Exchange (ICEX):*** It is a screen based on-line derivatives exchange for commodities. It has robust assaying and warehousing facilities in order to facilitate deliveries. It has Reliance Exchange Next Ltd. as anchor investor and has MMTC Ltd., India Bulls Financial Services Ltd., Indian Potash Ltd., KRIBHCO and IDFC among others, as its partners.

The head office is located in Mumbai and has regional offices spread across the country which covers agri belt, with a vision to encourage participation of farmers, traders and actual users to hedge their positions against the wide price fluctuations.

It provides the widest range of benchmark future products available on any exchange, covering all major commodities. It offers future trading in Agriculture Commodities, Bullions, Base Metals and Energy.

(d) *National Multi-Commodity Exchange of India (NMCE):* It is the first demutualized Electronic Multi-Commodity Exchange of India and has been granted the National status on a permanent basis by the Government of India. NMCE has been operational from 26th November 2002.

It is promoted by commodity-relevant public institutions, viz., Central Warehousing Corporation (CWC), National Agricultural Cooperative Marketing Federation of India (NAFED), Gujarat Agro-Industries Corporation Limited (GAICL), Gujarat State Agricultural Marketing Board (GSAMB), National Institute of Agricultural Marketing (NIAM), and Neptune Overseas Limited (NOL) and Punjab National Bank (PNB).

There are many positive features of NMCE. It is a zero debt company and has been regularly following prudent accounting and auditing practices. The delivery mechanism is very good which makes it the most suitable participants in the physical commodity market.

To attract speculative volume, the exchange does not compromise on delivery mechanism. The main motive is public interest rather than commercial considerations. It has transparent rule based procedures which has almost eliminated any conflict of interest.

2.5 International Commodity Exchanges

Major international commodity exchanges of the world are briefly discussed as below:

- **Chicago Mercantile Exchange (CME):** It is a financial and commodity derivatives trading platform which has its headquarter in Chicago. It was established in 1898 as the Chicago Butter and Egg Board. Presently, Chicago offers contract of all kinds which includes agriculture, credit, equity index, interest rates and other futures/options investments.
- **Chicago Board of Trade (CBOT):** It is formed in 1848 and being considered among oldest future/options trading exchanges in the world. The exchange offers more than 50 different futures and option contracts for investors which scattered over a number of asset classes.
- **New York Mercantile Exchange (NYMEX):** The NYMEX is the world's largest physical commodity futures exchange, which offers a wide variety of products. Commodity Exchange Inc. (COMEX) which acts as a division of the NYMEX also offers exposure to various metals contracts.
- **London Metal Exchange (LME):** LME was established in 1877. However, it has its roots in 1571, when the Royal Exchange in London was founded, trading only copper at that time. It is a major exchange which offers exposure to futures and options of a various varieties of base metals and other commodity products. Some of the metals which have been traded include aluminum, copper, tin, nickel, zinc, and lead..

- **Intercontinental Exchange Inc. (ICE):** The Intercontinental Exchange is an American company which operates futures and over-the-counter contracts through internet. In the beginning, the company was operating energy contracts but has increased its scope by offering exposure to a number of commodities including cocoa, cotton, sugar, iron ore, natural gas and crude products.

3. INTERMEDIARIES IN THE CAPITAL MARKET

The following market intermediaries are involved in the Capital Market:

- Merchant Bankers
- Registrars to an issue and Share Transfer Agents
- Underwriters
- Bankers to issue
- Debenture Trustees
- Portfolio managers
- Stock brokers and sub-broker

We will discuss them one by one in the following paragraphs:

3.1 Merchant Bankers

SEBI (Merchant Banker) Regulations, 1992, define 'merchant banker' as any person who is engaged in the business of issue management, either by making arrangements regarding selling, buying, or subscribing, or acting as a manager, consultant, or advisor, or rendering corporate-advisory services in relation to such issue management.

In case of both the public issues and right issues, it is mandatory to appoint a Merchant Banker. The task of Merchant Banker is basically that of a facilitator or coordinator. It coordinates the process of issue management by helping the underwriters, registrars and bankers, in pricing and marketing the issue and complying with the SEBI guidelines.

Merchant Bankers are prohibited from carrying on certain activities such as acceptance of deposits, leasing and bill discounting. They are not allowed to borrow any money from the market. They are also debarred from engaging in the acquisition and sale of securities on a commercial basis.

3.2 Registrars to an issue and Share Transfer Agents

'Registrar to an Issue' means a person who is involved with the following activities:

(a) Collecting applications on behalf of the investors and keep a proper record of monies received and paid.

(b) Helping the company which has issued shares in determining the basis of allotment of the securities in consultation with the stock exchange.

(c) Finalizing the list of person entitled to allotment of securities.

(d) Processing and dispatch of allotment letters, share certificates and refund orders.

'Share Transfer Agent' means a person who on behalf of the issuer company maintains the records of holders of securities issued by such company.

The Registrars to an Issue and Share Transfer Agents are important intermediaries in the primary market. They help in mobilizing new capital and ensure that proper records of the details of the investors maintained, so that the decisions regarding basis for allotment and the number of securities to be allotted can be smoothly implemented.

3.3 Underwriters

An underwriter is a person who engages in the business of underwriting the public issue of securities of a particular company. An underwriting is an arrangement in which a SEBI registered underwriter gives an undertaking to the issuing company that in case the company's public issue is not fully subscribed, the underwriter will purchase the unsubscribed portion of the public issue.

Underwriting is compulsory for a public issue. It is necessary for a public company which invites public subscription for its securities to ensure that 90% of its public issue is fully subscribed otherwise the whole issued amount has to be refunded. The company cannot fully rely on advertisements to ensure full subscription. In case of any under subscription, it has to be made good by the underwriters. And, the underwriting agreement has to be made in advance of the opening of the public issue.

3.4 Bankers to an issue

Banker to an Issue means a scheduled bank doing any one of the following tasks:

(i) Acceptance of application money;

(ii) Acceptance of allotment or call money;

(iii) Refund of application money;

(iv) Payment of dividend or interest warrants.

Therefore, as the name indicates, Bankers to the issue carries out the important task of ensuring that the funds are collected and transferred to the Escrow accounts. The Banks do a great favour to the companies in mobilization of capital.

3.5 Debenture Trustee

A debenture trust deed is a document created by the company where debenture trustees are appointed to protect the interest of the debenture holders. To act as debenture trustee, the entity should either be a scheduled bank carrying on commercial activity, a public financial institution, an insurance company, or a body corporate. The entity should be registered with SEBI to act as a debenture trustee.The contract deed entered into with a debenture trustee must specify the interest rate and date of interest and principal repayments.

Duties of the Debenture Trustee include:

(a) Call for periodical reports from the body corporate, i.e., issuer of debentures.

(b) Take possession of trust property in accordance with the provisions of the trust deed.

(c) Enforce security in the interest of the debenture holders.

(d) Ensure on a continuous basis that the property charged to the debenture is available and adequate at all times to discharge the interest and principal amount payable in respect of the debentures and that such property is free from any other encumbrances except those which are specifically agreed with the debenture trustee.

(e) Exercise due diligence to ensure compliance by the body corporate with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed.

(f) To take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice.

(g) To ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debenture holders.

(h) Inform the Board immediately of any breach of trust deed or provision of any law.

(i) Appoint a nominee director on the board of the body corporate when required.

(Source: SEBI FAQ's - Debenture Trustee)

3.6 Portfolio Managers

As per SEBI, a portfolio manager is a body corporate who, pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise), the management or administration of a portfolio of securities or the funds of the client.

Simply stated, a portfolio manager is a person who is responsible for investing a fund's assets, monitoring investment strategy and doing day-to-day trading. A portfolio manager manages mutual funds and other investment funds, such as hedge or venture funds. He may be an experienced investor, a broker, a fund manager, or a trader with good knowledge of industry and a having a track record of producing good results.

The portfolio manager provides to the client the Disclosure Document at least two days prior to entering into an agreement with the client. The Disclosure Document contains the quantum and manner of payment of fees payable by the client for each activity, portfolio risks, complete disclosures in respect of transactions with related parties, the performance of the portfolio manager and the audited financial statements of the portfolio manager for the immediately preceding three years. Please note that the disclosure document is neither approved nor disapproved by SEBI nor does SEBI certify the accuracy or adequacy of the contents of the Documents.

(Source: SEBI FAQ's - Portfolio Managers)

3.7 Stock brokers and Sub-Broker

Stock broker is a person who buys and sells stocks and other securities for its clients through a stock exchange. Stock brokers should be registered with SEBI and are governed by SEBI Act and Securities Contract Regulation Act. Stock brokers may also call themselves investment consultants and financial consultants. A stockbroker should have good knowledge about the securities market. Further, he should be good with numbers, have excellent interpersonal skills and should be attentive enough not to oversee any important details.

On the other hand, a sub broker is a person who is not a trading Member of a Stock Exchange but who acts on behalf of a trading member as an agent. His task is to help investors in dealing in securities through such trading members (brokers). The leading stock brokers in India are listed as below:

- India Infoline
- ICICI Direct
- Share Khan
- India Bulls
- Geojit Securities
- HDFC
- Reliance Money
- Religare
- Angel Broking

4. INSTITUTIONAL INVESTORS

An institutional investor is a large organization that has large cash reserves by which it invests in securities and other investment assets. Institutional investors include endowment funds, hedge funds, insurance companies, pension funds, mutual funds, etc. An institutional investor is basically a non-bank organization that trades in large quantities to qualify for preferential treatment. They are considered as specialized investors and supply capital to organization that required funds or are in dire straits. Moreover, they exert good influence in the management of the corporations exercising voting rights.

So, basically, an institutional investor is an organization that invests on behalf of the investors. Institutional investors have the required resources to do detailed research on various investment avenues, and because of their extensive knowledge, they generally have an edge over retail investors. Various institutional investors are briefly discussed as below:

(i) Commercial Banks: They play an important role in taking deposits from the public and giving loans to various sectors of the economy. A sound banking system ensures that mobilized savings are effectively deployed to needy sectors of the economy. When banks provide loan in the form of working capital, they are providing loan for funding the current assets. The working capital loan should be of short term in nature and it is given in the form of a limit.

Banks provide long term loan for asset purchase as well as margin money for working capital purpose. In the case of asset purchase, a bank would provide a long- term loan which would be repaid either from the cash flow generated from the business or from refinancing or disinvestment. In such a case, the security is generally created on the asset which is purchased out of the term loan. Besides, some other collateral is also taken as security in the form of term loan. In the case of term loan for working capital purpose, generally, other assets are taken as security. This asset can be immovable properties the borrower happens to have.

(ii) Insurance Companies: Insurance is basically the process of safeguarding the interest of people from loss and uncertainty. Insurance companies do a lot of service to the economy of the nation by protecting companies from contingencies and compensate them from any loss. They collect premiums for providing these services. The role and responsibilities of insurance companies have been outlined as below:

a) The insurance companies provide safety and security against a particular event.

b) They generate financial resources by collecting premiums and utilizing the premium amount for fruitful investment purposes.

c) Life insurance encourages savings through payment of regular premium amount.

d) The insurance companies promote economic growth by making accumulated capital into productive investment purposes. They help to reduce loss, bring financial stability by providing compensation at the time of any uncertain event and promote trade and commerce activities resulting into economic growth and development.

e) And, last but not the least, insurance help in shifting of risk from the insured to the insurer.

(iii) Mutual Funds: Mutual Fund is a trust that pools together the savings of investors by making investments in the capital market thereby making the investor to be a part owner of the assets of the mutual fund. The fund is managed by a professional money manager who invests the money collected from different investors in various stocks, bonds or other securities according to specific investment objectives as established by the fund. If the value of the mutual fund investments goes up, the return on them increases and vice versa. The net income earned on the funds, along with capital appreciation of the investment, is shared amongst the unit holders in proportion to the units owned by them. Mutual Fund is therefore an indirect vehicle for the investor investing in capital markets. In return for administering the fund and managing its investment portfolio, the fund manager charges fees based on the value of the fund's assets.

(iv) Pension Funds: A pension fund is a fund from which pensions are paid which are accumulated from contributions from employers and employees. Pension systems throughout the world have been under close scrutiny over the last couple of decades. Numerous reforms have been carried out to tackle the sustainability and adequacy of pension arrangements in the face of the rising global demographic challenge.

In India, now Pension funds are regulated by Pension Fund Regulatory and Development Authority (PFRDA). Moreover, the funds contributed by the Subscribers are invested by the Pension Fund Regulatory and Development Authority (PFRDA) registered Pension Fund Managers (PFM's) as per the investment guidelines provided by PFRDA. The investment guidelines are framed in a very professional manner in such a way that there is negligible effect on the subscribers contributions even if the market is not doing well by a prudent mix of investment vehicles like Government securities, corporate bonds and equities.

(v) Endowment Funds: An endowment fund is an investment vehicle where periodic withdrawal from the money invested into the fund is possible. The money put into the endowment funds, is often used by universities, nonprofit organizations, churches and hospitals, and is generally used for specific requirement or to give a boost to the company's operating process.

An endowment fund is a financial asset, basically held by a non-profit organization, which contains the capital investments and related earnings used by the non-profit organization to fund the overall objective of the organization. Further, endowment funds are organized by stringent contractual obligations and rules to be followed by the non-profit organization. The main aim of the fund is to further the goal of the long-term financial health of the non-profit organization and its beneficiaries.

(vi) Hedge Funds: A hedge fund can be explained as a package of funds that takes both short and long positions, buys and sells equities, initiates arbitrage, and trades bonds, currencies, convertible securities, commodities and derivative products to give returns at minimum possible risk. The hedge fund tries to minimize risks to investor's capital against market volatility by employing various hedging strategies as outlined above. Hedge fund investors typically include High Networth Individuals (HNIs), endowments and pension funds, insurance companies, and banks. These funds work either as private investment partnerships or offshore investment companies.

5. FOREIGN PORTFOLIO INVESTORS (FPIS)

Who are FPIs?

FPIs are basically registered foreign funds, which put their money in the stock markets in India. They invest through various methods in the capital market that is either in the debt segment or in the equity segment. Therefore, a FPI is an investor or investment fund that is registered in a country outside of the one in which it is currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds. If we try to explain it in the Indian context, it refers to foreign companies investing in the financial markets of India. The Institutional investors based internationally must register with the Securities and Exchange Board of India (SEBI) to participate in the market.

Categorization of FPIs

Before making its investment in India, the FPI shall obtain a certificate of registration from a designated depository participant on behalf of the SEBI. They can be divided into three categories:

(i) Category 1 includes Government and Government related investors such as central banks, government agencies, sovereign wealth funds and international or multilateral organizations or agencies.

(ii) Category 2 includes

  (a) Regulated funds such as mutual funds, investment trusts, insurance/reinsurance companies,

  (b) Regulated persons such as banks, asset management companies, investment managers/advisors and portfolio managers,

  (c) University funds and endowments and pension funds.

(iii) Category 3 includes such investors such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices.

An interesting fact about FPIs

Foreign Portfolio Investors have made good money in the last few years. However, the problem for the Indian markets right now is that if interest rates in the US rise, they may sell stocks they held in the Indian Stock Market to make higher yields in the US. The reason for this action is that they may earn higher return in the US than what they may earn by investing in the Indian Stock market. This may lead to high sell off in the Indian Capital market. So, interest rate hike by US Fed can influence the Indian Stock Market hugely.

Recent developments in FPIs

As per the SEBI (Foreign Portfolio Investors) (Second Amendment) Regulations, 2017 which is effective from 27 February 2017, FPIs are permitted to invest in the following:

- Unlisted corporate debt securities in the form of non-convertible debentures/bonds issued by public or private Indian companies;
- Securitized debt instruments, under:

  (i) any certificate or instrument issued by a special purpose vehicle (SPV) set up for securitisation of asset/s where banks, FIs or NBFCs are originators; or

(ii) any certificate or instrument issued and listed in terms of the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.

- Investment by FPIs in the unlisted corporate debt securities and securitised debt instruments shall not exceed INR 35,000 cr within the extant Corporate debt limit which currently is INR 2,44,323 cr.
- Further, investment by FPIs in securitised debt instruments shall not be subject to the minimum 3-year residual maturity requirement; and
- All other existing terms and conditions for FPI investments in corporate debt securities shall continue to apply.

Foreign Portfolio Investors tend to chase returns and in the last 2-3 years, they have made good money. The problem for the Indian markets right now, is that if interest rates in the US rise, they may sell Indian stocks, to chase higher yields in the US. This can lead to a significant sell-off in the Indian markets. This is because FPIs have invested heavily in the Indian markets.

6. CUSTODIANS

The custodians play a critical role in the secondary market. SEBI Custodian of Securities Regulation, 1996 was framed for the proper conduct of their business. According to SEBI regulations, custodial services in relation to securities of a client or gold/gold related instrument held by a mutual fund or title deeds of real estate assets held by a real estate mutual fund mean safekeeping of such securities or gold/gold related instruments or title deeds of real estate assets and providing related services.

The related services provided by them are as follows:

- Maintaining accounts of the securities of a client.
- Collecting the benefits /rights accruing to the client in respect of securities.
- Keeping the client informed of the actions taken by issuer of securities.
- Maintaining and reconciling records of the services as referred above.

Further, every custodian should appoint a compliance officer to monitor the compliance of SEBI Act and its various rules, regulations and guidelines and also for redressal of investor grievances. The compliance officer should immediately report any non-compliance observed by him to the SEBI.

SEBI can also ask for information from the custodian in regard to his activities. Such information has to be given within a reasonable period as laid down by SEBI. Further, SEBI is also empowered to conduct inspection/investigation including audit of books of account, records etc. of custodians to ensure that they are being properly maintained. SEBI's task is also to ascertain that compliance of provisions of SEBI Act and its regulations have been duly complied with. Moreover, his job is also to investigate into complaints received from the investors or clients.

7. CLEARING HOUSES

Clearing house is an exchange-associated body charged with the function of ensuring (guaranteeing) the financial integrity of each trade. Orders are cleared by means of the clearinghouse acting as the buyer to all sellers and the seller to all buyers. Clearing houses provide a range of services related to the guarantee of contracts, clearance and settlement of trades, and management of risk for their members and associated exchanges.

7.1 Role of Clearing Houses

- It ensures adherence to the system and procedures for smooth trading.
- It minimises credit risks by being a counter party to all trades.
- It involves daily accounting of all gains or losses.
- It ensures delivery of payment for assets on the maturity dates for all outstanding contracts.
- It monitors the maintenance of speculation margins.

7.2 Working of Clearing Houses

The clearing house acts as the medium of transaction between the buyer and the seller. Every contract between a buyer and a seller is substituted by two contracts so that clearing house becomes the buyer to every seller and the seller to every buyer. In a transaction where P sells futures to R, R is replaced by the clearinghouse and the risk taken by P becomes insignificant. Similarly, the credit risk of R is taken over by the clearing house; thus, the credit risk is now assumed by the clearing house rather than by individuals. The credit risk of the clearing house is then minimised by employing some deposits as collaterals by both, buyers and sellers. These deposits, known as margins, are levied on each transaction depending upon the volatility of the instrument and adjusted everyday for price movements. Margins, which normally are in form of cash or T-bills, can be categorised into the following types: -

- *Initial Margins on Securities:* It is paid by purchasers and short sellers, generally function as a security for loan, and is similar to a down payment required for the purchase of a security.
- *Initial Margins on Derivatives:* It refers to funds paid as guarantee to ensure that the party to the transaction will perform its obligation under the contract. Initial margin on derivatives is designed to cover future changes that may occur in the value.
- *Maintenance Margins:* It refers to the value over and above the initial margin, which must be maintained in a margin account at all times after the initial margin requirement, if any, is satisfied.
- *Variation Margin:* It refers to funds that are required to be deposited in, or paid out of, a margin account that reflects changes in the value of the relevant instrument.

7.3 Trading Procedure of Clearing Houses

Clients have to open an account with a member of the exchange. When they want to trade in futures, they instruct members to execute orders in their account. The trade details are reported to the clearing house. If a member of the exchange is also a member of clearing house, then he directly deposits the margins with the clearing house. If he is not a member then he should route all transactions through a clearing member for maintaining margins.

CHAPTER 7

COMMODITY MARKET

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- What are Commodity Markets
- Role of Commodity Markets
- Commodity Market in India
- Application of Derivative in Commodities
- Global Commodities Exchanges

1. INTRODUCTION

Like financial markets which deals with money and shares, the commodity markets deal with trading of 'commodities' like metals, raw material commodities like cotton, pulses etc. In fact the commodity market is the foremost form of market which was structured more of a barter of commodity exchanges – usually dissimilar products – which later on got one leg as money as time progressed. The contemporary commodity market is as sophisticated as its stock market counterpart, with the only distinction being commodities, instead of stocks, traded.

The commodity market is absolutely essential to understand how the prices get influenced by many of factors ranging from monsoon predictions to political decisions. The commodity market acts as the barometer of how the markets perceive these factors, which in turn will impact the demand-supply dynamics, thereby influencing the futures prices. This leads to a market driven price discovery mechanism.

For example, a farmer, will be very much interested to 'lock in' prices for his harvest of pulses next crop season due in 3 months. Hence, he would 'sell' an estimated quantity, say 100 kilograms (kg.) of his future produce at future rate of Rs. 80 per kg, thereby assuring himself of a fixed price.

A wholesaler into pulses will similarly like to have a committed purchase price, and would enter into the 'buy' leg at Rs. 80 per kg. Assume after 3 months, the contract closes out at 81 per kg. That means the farmer has lost Rs 1 per kg whereas the wholesaler has gained by Re 1 per kg. Of course, the contracts are settled in cash – rarely there is actual physical delivery of the commodities involved.

2. ROLE OF COMMODITY MARKETS

Since the ancient times people used to trade in primary commodities like cotton, spices, and livestock. The traders used to engage in futures with the time frame normally that of the harvest duration. Later with the advent of the Industrial Revolution, people started trading in base metals. In the 2000s, the matured economies of US and UK also started to have exchange traded commodities (ETCs) and exchange traded funds (ETFs).

The major role of the early commodity markets was to:

a) Act as a platform for enabling farm produce growers and the end buyers to interact.

b) Enabling intermediaries to engage in representing both the demand and the supply side of the commodity chain.

c) Price discovery.

Even today the above characteristics hold good in commodity exchanges. The added feature is of course, a regulated market that is transparent, and real time.

2.1 Influence of commodity markets on prices

Commodity markets influence prices at two levels:

a. Enabling as a platform for both demand and supply factors to determine the prices for a particular commodity or grade of a particular commodity.

b. Acting as an indicator for produce growers to take informed decision on which product to grow to reap better prices.

Essentially both the above objectives culminate to price discovery.

However, it's very important that the information that is getting used to determine the price is real time, and transmitted across markets. In structured markets, the market prices are close to the 'fair value' prices.

2.2 Negative Impact of Speculation

The bane of the commodity market is speculation driven trades and short selling done to gain short-term profits. Precious metals like gold and diamond attract speculative investors given the hedge value of these assets. In some cases, there are also instances of black money and money laundering that mires the true features of an efficient commodity market. A report released by World Bank in 2012 has laid the blame that ‘food prices globally soared by 10 percent’ squarely on the want on speculative trades executed in parts of the globe.

Speculation cannot be ended in any market, however they can be regulated and offenders treated with high penalties. The European Securities and Markets Authority (ESMA), based in Paris and formed in 2011, is an "EU-wide financial markets watchdog", which aims at orderly pricing and settlement conditions. The individual exchanges also have brought their own checking mechanisms like position limits, trade cutoffs, etc. to discourage pure arbitrage traders.

3. COMMODITY MARKET IN INDIA

3.1 Indian Commodity Markets

MCX (Multi Commodity Exchange of India Limited) and the NCDEX (National Commodity & Derivatives Exchange Limited) are the primary commodity trading platforms in India. MCX is a commodity futures exchange started in 2003, and is listed on the BSE. NCDEX is another exchange that is promoted jointly by LIC, NABARD, etc and has a robust online trading system.

The NCDEX has its own index called the ‘Dhaanya’- Dhaanya is a value weighted index, computed in real time using the prices of the 10 most liquid commodity futures traded on the NCDEX platform.

The below is a screen shot of the same –

Last	Open	High	Low	Previous Close
2967.82 (-3.18 -0.11%)	2971.00	2979.90	2959.05	2971.00

Constituents	Expiry	LTP	Open	High	Low	Prev. Close	Change
Castor Seed	May 19, 2017	4414	4475	4492	4388	4496	-1.82
Coriander	May 19, 2017	5562	5477	5700	5477	5646	-1.49
Cotton Seed Oilcake	May 19, 2017	1893	1860	1906	1860	1853	2.16
Guar Seed 10 MT	May 19, 2017	3660	3656	3680	3639	3648	0.33
Jeera	May 19, 2017	18410	18490	18525	18365	18395	0.08
Mustardseed	May 19, 2017	3725	3699	3737	3698	3702	0.62
Soy Bean	May 19, 2017	2845	2845	2853	2840	2841	0.14
Sugar M Grade	Jul 20, 2017	3795	3795	3795	3795	3788	0.18
Turmeric	May 19, 2017	5624	5668	5694	5538	5558	1.19
Wheat	May 19, 2017	1600	1597	1600	1597	1591	0.57

3.2 Problems with the Indian Commodity Markets

The Indian markets have been plagued by the 'speculator' and 'fly-by-night' operators. The Chairman of the now defunct NSEL (National Spot Exchange Limited) had to be arrested for having entered into futures markets without adequate documentation – many commodities that were traded didn't have any underlying to them. SEBI has passed tough strictures on fresh forward contracts in the commodity markets in Feb 2016, and it has derecognized OTCEI (Over-the-counter exchange of India).

Another big problem is that the commodity markets have not been able to see the 'exponential' growth that is required for platforms to sustain it. The basic problem is of 'inclusion' – farmers that form the backbone of agri-based commodities are not able to connect to the market, even though both MCX and NCDEX have created several awareness programs towards the same.

Political ramifications have also added to the woes – price sensitive commodities like sugar have been on and off the futures platform.

3.3 Way Forward

Needless to say, the commodity markets in India have a long way to go to becoming globally competent. There is a persisting need to close the chain between farmers to markets, which is even more challenging given that the hold of intermediaries is too strong in Indian scenario. An impetus from the government is also required in order to both educate and popularize the adoption of commodity markets in India.

3.4 Regulatory scenario in India

In India, the FMC was the chief regulator of commodity futures markets in India, before it got merged with SEBI. The government, considering it wise to bring the commodity market under a common regulator, repealed the Forward Contracts Regulation Act (FCRA) 1952 and the regulation of commodity derivatives market shifted to Securities and Exchange Board of India (SEBI) under Securities Contracts Regulation Act (SCRA) 1956 with effect from 28th September, 2015.

4. APPLICATION OF DERIVATIVE IN COMMODITIES

4.1 Commodity Markets

It should be noted that following are some of the differences between commodity and financial derivatives:

(i) **Storage Cost:** Commodities especially agricultural commodities are perishable in nature and they require storage. Due to this reason, the buyer has to bear the cost of storage and transportation charges. In case if location of goods is not in the same state then, the buyer also has to borne taxes, octroi etc. However, storage cost is not there in financial derivatives.

(ii) Complexity: Compared to Financial Market, there are low volumes of transactions and transparency in commodity market, and, thus, often relationship between future and spot get distorted. Further, delivery in financial market is comparatively less cumbersome.

(iii) Higher Cost: While in financial market, only cost in the form of interest cost and exchange rate loss are involved, while in commodity market a lot of costs are involved such as transportation, delivery, storage etc.

(iv) Physical Delivery: Since the quality of goods commodities even in two different batches cannot be same, the delivery of commodities becomes a challenging task. Stating otherwise, this is the most distinguishing feature of commodity derivatives.

4.2 Pre-requisites for Futures trading on a Commodity Exchange

For a future to be traded on a Commodity Exchange, following are the prerequisites:

(i) Durability - Commodity should be storable and durable.

(ii) Homogeneity - The commodity should be homogeneous in nature.

(iii) Free from Control - The trading in commodity should be free from any type of price or regulatory control.

(iv) Frequent Trading - The demand and supply should be large leading to daily fluctuation in prices. Practically, it has been seen that despite the fact that same commodities possess above characteristics it still required to be traded successfully.

4.3 Trading and Settlement Process

Broadly, commodity trading involves following three mechanisms:

(i) Order Matching Mechanism - Firstly, a trader places his/her order with any registered broker who in turn enter the same into online terminal. In case order matches with opposite order (one party buys and other party sells) the trade is said to be complete.

(ii) Trade Clearing Mechanism - For matched order clearing takes place through a Registered Clearing House. The function of these clearing houses is as follows: -

(a) Follow up with parties

(b) Timely Settlement

(c) Delivery versus payment (DVP) of commodity traded.

(d) In case of non-delivery settlement through fund transfer.

(iii) Processing of Delivery - The main issues to be considered in the delivery processes are as follows:

(a) Availability of warehouse

(b) Location of order

(c) Quantity of Commodity deposited and dematerialized.

Further, delivery process involves following steps:

(i) Buyer request Depository Participant (DP) to deliver the commodity.

(ii) DP forward this requests to the Registrar and then to Transfer Agent.

(iii) Transfer Agent after verifying authenticity of request passes the details of delivery to the warehouse.

(iv) After thorough identification checking, a warehouse arranges the delivery of the concerned goods to the designated buyer.

4.4 SEBI's Approval for Option in Commodities

Recently, SEBI allowed for the option trading in Commodity Future market. On expiry date, if option ends in Out The Money (OTM) position it will be squared off at loss (premium) and the holder of In The Money (ITM) position will have a choice either to square it off at profit or get converted into a Future Contract. Once it is converted into future contract it will be subject to margin requirement as other future contracts.

4.5 Critical Terms to be understood (A Revisit)

a) **Short position in a contract***:* The party who agrees to deliver (sell) the contracted commodity.

b) **Long position in a contract***:* The party who agrees to receive (purchase) the contracted commodity.

c) **Futures Contract***:* The formal agreement where one party agrees to take a short position and another party assumes the long position on contracted commodity. The contract will specify the quantity and quality of the commodity, the specific price per unit, and the date and method of delivery. Please remember that a future is a derivative contract.

d) **Settlement:** The close out day of the futures contract. The positions get wound and the resulting profit / loss of either party gets settled in cash.

e) **Margin:** This is perhaps the most important term in commodity futures – the parties entering into a contract must furnish a margin equal to a % (usually 5 to 15 percent) of the contract value. Traders are required to keep margin monies usually based on the traded volumes.

f) **Open:** This is the opening price of the trade

g) **High:** The highest price in the trading session / day

h) **Low:** The lowest price in the trading session / day

i) **Open Interest (Volume):** The number of open positions of contracts

j) **Expiry Date:** The closure date of the contract

k) **LTP:** Last traded price

l) **Unit traded:** The unit of measurement (For eg: Cotton will be measured in 'bales')

4.6 The Role of Derivatives

(i) **Forward Contract:** This is the simplest of all contracts, which states that there would be an exchange of an agreed quantity of given commodity at a particular price (the forward price).

(ii) **Futures Contract:** These are standardized forward contracts that are done through an exchange, for a particular quantity of commodity at a particular future date and location, the price is left undetermined.

(iii) **ETCs:** Exchange traded commodities are the commodities that are contracted at based on ETFs. They track the performance of an underlying commodity index including total return indices based on a single commodity.

5. GLOBAL COMMODITIES EXCHANGES

5.1 London Metal Exchange (LME)

The iconic London Metal Exchange, popularly referred to as 'LME,' is the world's largest futures exchange market established in 1877, when Great Britain was at the peak of its glory. With half the world under the British Empire, London had become the epicenter of commodity trades of all kinds. Shortly the industrial revolution further spurred the growth of markets for metals like copper, tin, and aluminum. The 'three month contract' which is now considered as the standard period for a future, was actually borne out of the time frame that took copper to be shipped from Chile to UK. The opening of Suez Canal in 1869 similarly reduced the time for shipment of tin to arrive from Malaya to 3 months, which gave rise to the '3 month contract' now in vogue.

LME was acquired in 2012 by Hong Kong Exchanges & Clearing Limited and a new custom clearing house was designed and introduced to bring technology into the global metal trade platform.

Today, LME sets the standards for operating in the commodity metals market within the framework of corporate governance – LME has an operational committee for each of the metal traded, like an 'aluminum' committee for aluminum, a 'molybdenum' committee for molybdenum, and so on. LME also has an elaborate 'Ring Disciplinary' committee and an appeal mechanism for both traders and members in place.

The LME price discovery mechanism works in all the three ways –

a) *Open out-cry* – the trading floor on the LME that is also called as the 'Ring', where the prices are determined on the traditional out-cry (verbal) method,

b) *LME Select* – the electronic trading platform, and,

c) Inter-office telephone market system.

Thus, the LME is active for trading 24 hours a day. There is a common misconception that precious metals like gold are traded on the LME, but they aren't. The LME specializes in ferrous and non ferrous metals, whereas gold and silver are traded on the OTC managed by London Bullion Market.

5.2 Eurex Exchange

Eurex is the largest European futures and options market, established in Germany. One of the foremost exchanges to usher in electronic trading, its trading platform T7 is considered to be the best in the world. Eurex is constantly pushing itself to explore new areas and product classes, for example, they have introduced a factor index based futures that allow investors to trade six individual risk factors in futures format. The six factors are - size, value, carry, momentum, low risk and quality, and is a dynamic attempt to allocate to alternative sources of beta in an attempt to deliver equity-like returns with low correlation.

5.3 Chicago Mercantile Exchange (CME) Group

Chicago Mercantile Exchange & Chicago Board of Trade (CME) is the US based largest futures and options platform for trading. Established in 1898, CME offers the entire bouquet of trades based on ferrous, non-ferrous metals, precious metals, and even on weather and real-estate. The acquisition of New York Mercantile Exchange (NYMEX) by the CME group in 2007 catapulted it to the number one status in US. The platform also allows for agri-based commodity contracts like Class IV milk, Class III milk, Feeder Cattle etc. CME has developed 'SPAN' ('Standard Portfolio Analysis of Risk') which is standardized software to calculate margin requirements for futures, which has been adopted by many agencies as benchmark software across the globe.

Students are advised to supplement this chapter with the topic of Commodity Derivative from the Study Material of Strategic Financial Management Paper.

TEST YOUR KNOWLEDGE

Theoretical Questions

1. Explain how Commodity Derivatives are different from Financial Derivatives.
2. Which is standardized software to calculate margin requirements for futures developed by CME adopted by many agencies as benchmark software across the globe.

Practical Questions

1. A company is long on 10 MT of copper @ ₹ 474 per kg (spot) and intends to remain so for the ensuing quarter. The standard deviation of changes of its spot and future prices are 4% and 6% respectively, having correlation coefficient of 0.75.

   What is its hedge ratio? What is the amount of the copper future it should short to achieve a perfect hedge?

Answers to Theoretical Questions

1. Please refer paragraph 4.1
2. Please refer paragraph 5.3

Answers to the Practical Questions

1. The optional hedge ratio to minimize the variance of Hedger's position is given by:

$$H = \rho \frac{\sigma S}{\sigma F}$$

Where

σS= Standard deviation of ΔS

σF=Standard deviation of ΔF

ρ= coefficient of correlation between ΔS and ΔF

H= Hedge Ratio

ΔS = change in Spot price.

ΔF= change in Future price.

Accordingly

$$H = 0.75 \times \frac{0.04}{0.06} = 0.5$$

No. of contract to be short = 10 x 0.5 = 5

Amount = 5000 x ₹ 474 = ₹ 23,70,000

CHAPTER 8

BANKING AS SOURCE OF CAPITAL INCLUDING NBFCs

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Bank loans in the form of working capital loan
- Bank loans in the form of term loan
- Financing through Non-Banking Finance Companies (NBFCs)
- Concept of Project Financing
- Working Capital Management
- Reverse Mortgage

1. BANK LOANS IN THE FORM OF WORKING CAPITAL LOAN

When banks provide loan in the form of working capital, they are providing loan for funding the current assets. The working capital loan should be of short term in nature and it is given in the form of a limit. Banks specify a limit to a borrower and the borrower would be drawing the amount within the limit. This facility is called working capital facility. The working capital loan can be provided in Indian Rupees as well as in Foreign Currency. We shall first discuss different working capital loans in Indian Rupees.

1.1 Different products for Working Capital Loan in Indian Rupees

There are different products under which banks disburse the working capital product. These are given as below:

1.1.1 Cash - Credit Account

This is the most popular mode of loan product for funding the fund based working capital requirement of a company. Once the fund based limit has been assessed by the bank and the limit is in place after fulfillment of all the steps, the fund is made available through the cash- credit product. The account operates like a typical current account. At the time of first disbursement, the drawing power is fixed on the basis of the stock statement and the company is allowed to operate within this limit till the next month when a monthly stock statement would be submitted by the company. The company can deposit and withdraw money from the fund as many times as it wants. The Company would pay interest only on the outstanding amount on a daily product basis and the interest is charged on monthly basis. This is explained with the help of the following example:

A company has been sanctioned a fund- based working capital limit of ₹ 200 lacs and interest rate is Base Rate + 2% p.a, payable at monthly basis. The present Base Rate of the bank is 11%. The company avails this facility through a cash credit route. The stock statement submitted on 1st of September 2013, stipulates that the drawing power would be ₹ 190 lacs.

The transactions of the company are as follows:

Date	Particulars	Withdrawal	Deposit	Balance
3.9.13	To Electricity	15		15
5.9.13	To Salary	45		60
6.9.13	To Raw Material Supplier	100		160
10.9.13	To Other creditor	30		190
11.9.13	By Sales Proceeds		30	160
12.9.13	To purchase	25		185
16.9.13	By Sales		50	135
30.9.13	By Sales		80	55

Since the drawing power of the company is ₹ 190 lacs, the balance cannot exceed ₹ 190 lacs. The company can withdraw and deposit as many times as possible provided the balance is within ₹ 190 lacs. In the above- mentioned example, the company withdraws 5 times in a month and deposits 3 times in a month. This is one of the major advantages of the cash credit system enjoys by the corporate. The cash management responsibility is shifted to the bank. The bank has to block the entire ₹ 190 lacs for this account throughout this month though the company has only drawn this amount once i.e. on 10.9.13. If we define that the idle fund from this account is the difference in amount between the drawing power and the amount availed and the opportunity cost is 7.00% p.a the total opportunity cost is calculated below:

Date	Drawing Power (DP) ₹ lacs (A)	Balance ₹ lacs (B)	Idle Fund ₹ lacs (C) = (A) – (B)	Period (days) (D)	Cost ₹ lacs (E)
1.9.13	190		190	2	0.073
3.9.13	190	15	175	2	0.067
5.9.13	190	60	130	1	0.025
6.9.13	190	160	30	4	0.023
10.9.13	190	190	-	1	0.00
11.9.13	190	160	30	1	0.005
12.9.13	190	185	5	4	0.004
16.9.13	190	135	55	14	0.147
30.9.13	190	55	135	1	0.025
			Total	30	0.369

In the case of cash credit facility, the bank loses this amount due to idle fund. If the limit is substantially large, the idle fund cost is considerably higher. To help banks overcome this, RBI has stipulated a loan delivery mechanism for all the fund- based working capital limit. Under this system, 80% of the fund based working capital would be disbursed through a product called Working Capital Demand Loan (WCDL) where the repayment is to be specified by the borrower at the time of availing the disbursement. The maximum tenure of WCDL is 1 year and minimum tenure can be 7 days. The remaining 20% of limit can be availed through the normal cash credit route. In the case of WCDL, the cash management lies with the company.

Since, in this product the cash management lies in the hands of the borrower, the borrower would have the incentive of an interest rate concession. Depending on the bank involved, the cost of borrowing would be reduced to the extent of 50 basis points to 150 basis points.

1.1.2 Bill Discounting

Bill discounting is a product where a part of the receivable can be financed. Once the assessment of the company is carried out, a portion of the assessed limit representing part of the receivable can be financed through bill discounting mode. When a company sells goods on credit, receivable is generated in the books of accounts of the company. This receivable is of two types:

Open Account sales: Under this process only sales invoice and other sales related documents are drawn by the seller.

Bills Receivable: Under this process, not only all the documents associated with the open account sales are drawn but a Bill of Exchange is also drawn. A typical bill of exchange would look like:

Format of Bill of Exchange

₹ ______________/-   Date:

Please Pay ________________ (Payee) or Order a sum of Rs________________ - (Rupees ________________only) on 90 days (Credit Period) from the date of this document.

____

____

(Name & Address of Drawer)   (Name & Address of Drawee)

A scrutiny of the above-mentioned bills of exchange would reveal the following:

- It is an order given by the drawer of the bill of exchange to the drawee to pay to a party after certain days. Here the drawer is generally the seller and the drawee is generally the purchaser. The payee is the bank from whom the seller gets the credit under bill discounting scheme.
- Under normal circumstances, the seller would get the payment after 90 days from the buyer. This is the credit period extended by the seller to the buyer. This is also called the usance period of bills of exchange.
- To improve the cash flow, the seller can get the fund from the Payee immediately on submission of bills of exchange to a bank. The bank would send it for acceptance to the drawee and drawee will accept the bills of exchange to pay on due date.
- On receipt of acceptance from the drawee, the bank would pay to the drawer immediately.
- On due date, the bank would collect the money from the drawee. Since the bill of exchange is a negotiable instrument, protection under Negotiable Instrument Act is available to the payee.

Nowadays, this method of financing has become very popular for Small and Medium Enterprise (SME) financing. Many large companies outsourced their production facility to SMEs. These SMEs may not be financially strong enough to attract very competitive interest rates from the bank. The bank enters into arrangement where the large company which is the buyer of goods of SME would accept the Bills of Exchange drawn by the SME and in that case the exposure is shifted on the Large Company.

Besides, the above working capital product, there is another product by which a company can borrow short term funds. This is called Overdraft.

1.1.3 Overdraft

Overdraft is the facility by which an entity gets loan over and above the value of the security. This can be explained with the help of the following example:

A company has a fixed deposit of ₹ 5 lacs maturing on 15th September 2012.The fixed deposit was made on 15th September 2011 and the interest rate was 6.5% p.a. payable quarterly. Now, on 1st September, the company requires a fund of ₹ 5 lacs. The company has two options:

Option I: The Company closes the fixed deposits prematurely and in the process, it loses 1% interest. If the company exercises this option, it will earn interest to the tune of ₹ 27032/-.

Option II: The Company can take a loan for 15 days against the fixed deposit and continue with the deposit itself. The interest rate on loan of fixed deposit would be 1% higher than the interest rate of fixed deposit. In this case, the company pays 7.5% interest on ₹ 5 lacs for 15 days. The company in this process would earn ₹ 31760/- on its investment.

So in many cases, it is beneficial to avail an overdraft over the fixed deposit amount. This facility is called the overdraft. This is also a very popular retail banking product.

1.1.4 Factoring Services

Factoring services are the product by which the receivable is funded. In international transactions, factoring of receivable is also a very important corporate banking product. In most of the international trade transactions, besides the normal credit risks, it involves additional concepts of country and therefore sovereign risks come into play.

Sovereign risks in international business are usually of three broad categories:

Transaction Risk: It is linked to a specific transaction that involves a specific amount within a specific time frame, such as an export sale on six month’s draft terms;

Translation Risk: It stems from the obligation of multinational companies to translate foreign currency assets and liabilities into the parent company’s accounting currency regularly, a process that can give rise to book- keeping gains and losses;

Economic Risk: In the broadest sense, it encompasses all changes in a company’s international operating environment that generate real economic gains or losses.

1.1.4.1 International Factoring and its Advantages

The distinct advantages of a factoring transaction over other methods of finance/facilities provided to an exporter can be summarized as follows:

1. Immediate finance up to a certain percentage (say 75-80 percent) of the eligible export receivable. This pre-payment facility is available without a letter of credit – simply on the strength of the invoice(s) representing the shipment of goods.

2. Credit checking of all the prospective debtors in importing countries, through own databases of the export factor or by taking assistance from his counterpart(s) in importing countries known as import factor or established credit rating agencies.

3. Maintenance of entire sales ledger of the exporter including undertaking asset management functions. Constant liaison is maintained with the debtors in importing countries and collections are effected in a diplomatic but efficient manner, ensuring faster payment and safeguarding of financial costs.

4. Accordingly, bad debt protection up to full extent (100 percent) on all approved sales to agreed debtors ensuring total predictability of cash flows.

5. Efficient and fast communication system through letters, e-mail, and telephone or in person in the buyer's language and in line with the national business practices.

6. Consultancy services in areas relating to special conditions and regulations as applicable to the importing countries.

1.1.4.2 Types of International Factoring

The most important form of factoring is two- factor system.

Two- Factor System

The transaction is based on operation of two factoring companies in two different countries involving in all, four parties: Exporter, Importer, export Factor in exporter's country and import factor in importer's country.

The mechanics of operation in this arrangement works out as follows:

1. The exporter approaches the export factor with relevant information which, inter alia, may include:
    a) Type of business,
    b) Names and addresses of the debtors in various importing countries,
    c) Annual expected export turnover to each country,
    d) Number of invoices/credit notes per country,
    e) Payment terms and
    f) Line of credit required for each debtor.

2. Based on the information furnished, the export factor would contact his counterpart (import factor) in different countries to assess the creditworthiness of the various debtors.

3. The import factor makes a preliminary assessment as to his ability to give credit cover to the principal debtors.

4. Based on the positive response of the import factor, the factoring agreement is signed between the exporter and export factor.

5. Goods are sent by the exporter to the importer along with the original invoice which includes an assignment clause stipulating that the payment must be made to the import factor. Simultaneously, two copies of the invoice along with notifications of the debt are sent to the export factor. At this stage, prepayment up to an agreed per cent (say 75-80 percent) of the invoice(s) is made to the exporter by the export factor.

6. A copy of the invoice is sent by the export factor to his counterpart, that is the import factor. Henceforth, the responsibilities relating to book- keeping and collection of debts remain vested with the import factor.

7. Having collected the debts, the import factor remits the proceeds to his counterpart that is export factor. In case, payments are not received from any of the debtor(s) at the end of the previously agreed period on account of financial inability of the debtor concerned, the import factor has to pay the amount of the bill to his export counterpart from his own funds. However, this obligation will not apply in case of any dispute regarding quality, quantity, terms and conditions of supply etc. If any dispute arises, the same has to be settled between the parties concerned through the good offices of the factoring companies, otherwise legal action may have to be initiated by the import factor based on the instructions of the exporter/export factor.

8. On receipt of the proceeds of the debts realized, the retention held (say 15-20 percent) is released to the exporter. The entire factoring fee is debited to the exporter's account and the export factor remits the mutually agreed commission to his importing counterpart.

Thus, the export factor undertakes the exporter risk whereas the importer risk is taken care of by the import factor.

The main functions of the export factor relate to

(i) Assessment of the financial strength of the exporter.

(ii) Prepayment to the exporter after proper documentation and regular audit and post sanction control.

(iii) Follow- up with the import factor.

(iv) Sharing of commission with the import factor.

The import factor is primarily engaged in the areas of

(i) Maintaining books of exporter in respect of sales to the debtors of his country.

(ii) Collection of debts from the importers and remitting proceeds of the same to the export factor.

(iii) Providing credit protection in case of financial inability on the part of any of the debtors.

The two factor systems are by all means the best mode of providing the most effective factoring facilities to a prospective exporter. However, the system is also fraught with certain basic disadvantages, i.e. delay in operations like credit decision, remittance of fund, etc., due to involvement of many parties.

1.1.5 Dealer Financing

This is a new product by which banks are providing funds to the dealers of large companies. In this case, the large corporate, say, Maruti Udyog Limited would provide a list of dealers to a bank, say, HDFC bank Limited. Generally, the dealer selection would be carried out by the large corporate. The large corporate would identify the category A dealers and the same list would be forwarded to the bank. Now the bank would sanction a limit based on the intake of the dealer from the large corporate. Suppose a dealer purchases ₹ 250 lacs worth of car from Maruti Udyog Limited on monthly basis. Now HDFC bank would pay ₹ 200 lacs to Maruti Udyog Limited on behalf of the dealer. Then the dealer would make the payment to HDFC bank after 1 month with an interest rate. In such a case, the inventory to the tune of ₹ 250 lacs would be funded by HDFC bank. Now, the dealer may have already enjoying fund based limit from the banking system. So the dealer would inform the existing working capital banker that it has already availed ₹ 200 lacs from the HDFC bank and the same stock would not be shown in the inventory which the dealer would give to the existing bank for calculation of drawing power. In this case we have assumed a 20% margin on the inventory. The benefit to the dealer is that it would get lower rate of interest from the HDFC bank. In this type of financing there can be two types of credit enhancement:

- Maruti Udyog Limited would give some kind of guarantee that in case the dealer does not pay, it would make the payment. The payment may be a portion of the loan outstanding. However, in many cases when the principal - in this case Maruti Udyog Limited - is an AAA rated corporate, it may not give the corporate guarantee at all.
- In such a case, the principal may give a stop- order commitment. Under this mechanism, the principal would not dispatch any new consignment to the dealer in case HDFC bank informs it that the dealer has not paid the previous loan amount. Since the dealer is a category A dealer, the dealer may not be willing to land itself in such a situation. In such a case, it would lose its main business. The same product can be extended to many commodity dealers and large company customers.

1.1.6 Term Loan for working capital purpose

Besides the above mentioned working capital product, we can have a product which would cater to the working capital requirement; it is called term loan for augmentation of the margin money for working capital . Under this scheme, the banks would provide a term loan and the purpose of the loan is to augment the margin money for working capital. This can be explained with the help of a simple example:

Let us assume that as on March 31, 2014, a company is estimating a current asset of ₹ 300 million and other current liability of ₹ 30 million. The total working capital gap is ₹ 270 million.

Now the working capital banker would be providing a fund-based working capital limit to the tune of ₹ 180 million, stipulating that the borrower has to bring in ₹ 90 million in the form of margin money for working capital. Now as on March 31st, 2013 the company has Margin Money amounting to 75 million for Working Capital. So the company has to bring in an additional amount of 15 million in the form of augmentation of net working capital. The company decides to take ₹ 10 million from a bank in the form of a 3- year term loan. Such loan is called Margin Money For Working Capital Loan. This loan would be paid over a period of 3 years. The security of this loan cannot be the current asset. So the security of this loan would be in the form of other than current asset which can be noncurrent assets of the company or any other asset outside the company's books of account.

1.2 Different working capital product under Foreign Currency

One should always be aware about the competitive advantage of a particular type of borrowing source. Funds can be from the domestic sources as well as from the foreign sources, one should avail the right sources so that the overall cost goes down. Broadly, if a business borrows in foreign currency, then the total interest payment would be calculated as follows:

Benchmark Interest Rate (say 6 months LIBOR etc.) + Spread + Foreign Exchange Premium

Different working capital product under Foreign Currency has been discussed as follows:

1.2.1 Buyer's Credit

Suppose a business entity ABC Limited wants to import ₹200 million worth of raw material from Germany. Now the buyer i.e. ABC Limited has arranged a foreign fund of maximum 360 days from the date of import from HSBC Frankfurt. In case no such facility was there, ABC Limited would have to make the payment from the cash credit account, and for this amount, it has to pay the interest rate at Base Rate + Spread say 13% p.a. Now Indian bank would give a Financial Guarantee or Letter of Undertaking (LOU) or Stand By Letter of Credit (SLC) in favour of HSBC, Frankfurt that in case ABC Limited does not make the payment , it would make the payment . For this LOU /SLC/FBG, the Indian Bank would charge 1% p.a. to the customer ABC Limited. Now, once the customer submits this instrument to HSBC Bank, Frankfurt, HSBC bank would lend to ABC and ABC would make the payment towards its supplier. Now the interest rate would be in foreign currency. If the 6 months' dollar LIBOR is 0.5% p.a. and the spread is 150 bps and the forward premium is 600 bps the total cost of the borrowing is 8% p.a. When we add the FBG commission, the total cost comes to 9% p.a. So ABC could save a net of 4% p.a. interest rate on ₹ 200 million. The tenure of such buyer's credit would be a maximum of 360 days from the date of import. The Indian bank, while issuing the SLC/FBG, would now ear- mark the cash credit limit of the borrower. So the buyer's credit is disbursed under the sub- limit of Cash Credit Facility.

1.2.2 Pre shipment credit in foreign currency

If the business entity is exporting to the tune of pre shipment credit , funds can be disbursed under foreign currency . Such type of financing product is called PCFC. The benefit of this product is that the overall cost of fund is LIBOR + Spread. Since export is involved, it would lead to natural hedge and further hedging is not required. In fact, every exporter should avail this facility. Exporter should avoid availing fund under Rupee credit since the interest rate for such kind of financing would be charged as per Base Rate plus spread.

1.2.3 Post Shipment Credit in Foreign Currency (PSCFC)

Under this product, the post shipment credit to an exporter can be disbursed in foreign currency. The benefit for such type of product is that the cost of the borrowing would again be in LIBOR plus spread. Since the actual payment would come in USD, the credit would itself be self-liquidating in nature. In case the Indian business entity is neither importing nor exporting, the entity cannot borrow in foreign currency short term except FCNR(B) loan. Under this scheme, the customer would be able to borrow only in the form of FCNR (B) loan.

1.2.4 Foreign Currency Non Resident Bank Loan [FCNR (B)] Loan

This has been one of the most popular methods of working capital finance. Before going into the benefits of the product, we shall first discuss the product itself. Foreign Currency Non- Resident (Bank) is the name of a deposit scheme operated by Indian bank to collect deposits from Non Resident Indians and Overseas Corporate Bodies (OCB). These deposits are collected in United States Dollars (USD), Japanese Yen (JPY),Euro ,Great Britain Pounds (GBP),Canadian Dollar and Australian Dollar. The deposit can be taken for a minimum period of 12 months and a maximum period of 36 months. The interest and principal is to be paid in foreign currency. When a bank accepts FCNR (B) deposits, it accepts deposits in these foreign currencies. The Indian bank has the following options before it:

1. It keeps the deposit in the dollar form and invests in overseas bank account. The benefit of this mechanism is that the bank has fully hedged the currency conversion risk and the counter party risk is nil. The drawback of this mechanism is that in this process, the earning is substantially lower.

2. After accepting the deposits, the bank converts this foreign currency into domestic currency. Subsequently, it lends the domestic currency to the Indian company and earns domestic interest rate. On due date of payment of interest and principal, the bank converts the Indian currency into foreign currency as it has to pay back to the depositor both interest and principal in foreign currency. The benefit of this mechanism is that the earning to the bank is more. However, the drawback is that the bank incurs a foreign exchange risk.

3. There can be another process by which some of the benefits from both the alternatives can be retained. Such process would lead to the development of the product called FCNR(B) loan. In the case of FCNR (B) loan, the bank can lend to Indian corporate in foreign currency held by the bank under FCNR(B) deposit. The benefit to the bank is that without incurring the conversion risk (as mentioned under drawback in option 2), the bank can earn more as the Indian corporate would pay more compared to that of the foreign bank (as mentioned in option 1 above).

2. BANK LOAN IN THE FORM OF TERM LOAN

Banks provide long term loan for asset purchase as well as margin money for working capital purpose. In the case of asset purchase, a bank would provide a long- term loan which would be repaid either from the cash flow generated from the business or from refinancing or disinvestment. In such a case, the security is generally created on the asset which is purchased out of the term loan. Besides, some other collateral is also taken as security in the form of term loan. In the case of term loan for working capital purpose, generally, other assets are taken as security. Those assets can be immovable properties the borrower generally has.

Trade Credit for capital goods purchase

As discussed in the case of working capital, if the term loan is borrowed in the form of foreign currency, the interest cost can come down. However, there are certain restrictions on term loan which can be borrowed in foreign currency. One such facility is called suppliers credit or buyer's credit for import of capital goods. Since we have already discussed the mechanism of supplier's credit and buyer's credit , we shall not discuss the same.

3. FINANCING THROUGH NON-BANKING FINANCE COMPANIES

After discussing different sources of fund from the banking system, we shall now concentrate on the different funding options which a Non-Banking Financial Service Company (NBFC) provides to Indian borrowers.

NBFCs provide normal term loan in the form of different products. A few of the important products which are present in the market are:

- Loan Against Property
- Equipment Loan
- Term Loan
- Lease Rent Securitization
- Promoter Funding

3.1 Loan against Property (LAP)

If a business entity or its promoter is having an unencumbered immovable property, against this the NBFC would provide a loan. Generally, the loan amount is 65% of the market value of the property. The document requirement for such type of loan is relatively relaxed compared to the bank. Besides, end use restriction is also relaxed in such cases. In such cases, when the borrower requires funds for certain purpose and within short period of time, it can avail the loan in the form of Loan against Property.

The LAP fund can be used for the following purpose by the borrower:

(i) **Purchase of another asset:** LAP fund can be used for purchasing another real estate or land . Since banks fund cannot be used for purchase of land, many borrowers in India resort to this product for further purchase of land.

(ii) **Bringing in margin money for another loan from the bank:** A borrower needs to bring in margin money for any type of loan it takes from the bank. The borrower may not have the margin money in the form of cash. So the borrower or promoter can raise LAP from the NBFC and the same would be injected in the company as margin money. This is explained with the help of an example:

Example

ABC Limited, has a working capital limit of ₹ 35 crores for which it has to bring in the margin money for working capital to the tune of ₹ 3 crores. The company does not have cash and bank balance of more than ₹ 0.25 crores. But the promoter has immovable properties worth ₹ 5 crores. The promoter would take LAP to the tune of ₹ 2.75 crores from an NBFC with the company as a co- applicant. Now this money would be brought in the company by the promoter in the form of either unsecured loan or in the form of equity. Since LAP is given for a longer period i.e. a minimum of 7 years, the cash flow from the business would be sufficient to repay the LAP amount.

(iii) **Debt Consolidation purpose:** LAP is also used for Debt and Security Consolidation purpose. This is explained with the help of the following example.

Example

ABC Private Limited (ABPL) gave a 3000 square feet building located at Thane in Mumbai 10 years back as collateral to a banking facility of ₹ 20 lacs. At that time the value of the building was ₹ 18 lacs. Now the value of the building is ₹ 300 lacs. The overall borrowing has increased by ₹ 40 lacs. Now the company tells the bank to replace this security with another collateral of ₹ 80 lacs. However, most of the time the banker would not accept this. Now the company can take LAP of ₹ 45 lacs against the new collateral and bring own fund of ₹ 15 lacs and pay off the bank limit. Once the ₹ 300 lacs collateral is released from the bank, the company would now process the loan application for ₹ 60 lacs with a new bank where it would mention upfront that it would provide a collateral of ₹ 80 lacs. Once this loan is sanctioned, the LAP would be repaid by the borrower. This is known as security consolidation /debt consolidation.

(iv) **Promoter Funding:** This is another important product which NBFC can give. Due to capital market exposure, banks have restrictions on lending to the capital market. Now, for acquiring another company in the domestic market, bank borrowing cannot happen as it is prohibited by the RBI. So the borrower (acquirer) would approach the NBFC to fund such acquisition in the form of term loan. In such a case, the promoter shares are pledged if the company is listed or unlisted. If the company is unlisted, then apart from these shares, listed shares which promoter or company is holding in its books would also be taken as security.

4. PROJECT FINANCING

Banks provide facilities for two purposes. For building up current assets of the borrower, banks provide fund based and non-fund based facilities in the form of working capital. For building up current assets of the borrower, banks can provide project loan and term loan. The basic difference between Project Financing and Term Loan is that in the case of Project Financing, the loan is secured by way of primary securities and no collateral securities are available. Besides, the cash flow from the assets financed would only be available to repay the project finance loan.

In the case of term loan, the collateral security is available and other cash flows are also available over and above the cash flows from the primary assets. Since the assessment part is the same in the case of both kinds of financing, we shall be using terminology project financing and term loan interchangeably. Besides banks provide term loan for building up of assets which is other than current assets. So term loan is provided for the following purposes:

- Building up of fixed assets of the borrower
- Building up portion of current assets of the borrower
- Building up other non- current assets of the borrower

4.1 Determination of Project Cost & Means of Finance

The first step in any project loan assessment is the determination of project cost. Project cost calculations are different for different categories of term loan. If the term loan is provided only for the capacity expansion of a lower end SME, the project cost would be only the fixed assets cost. However, if we are giving the loan for setting up a new unit the project cost can be composed of three components:

(i) Fixed Asset Cost and Contingencies

(ii) Interest during Construction

(iii) Margin Money for working capital

So we can generalize the concept where the project cost can be defined as:

Project Cost = Fixed Asset Cost and Contingencies (I) + Interest During Construction (II) + Margin Money For Working Capital (III)

Depending on the nature of the borrower, we can exclude second and third component from the determination of project cost. One of the basic principles is that if the risk of the borrower is high then II and III would not be included in the project cost and this amount needs to be funded with equity. Similarly, in the case of existing unit, project cost would not include II and III part as this would be funded purely by the equity part. However, if the borrower is a good borrower and its credibility is high, we can include both II and III.

4.2 Fixed Asset Cost determination

First lenders would ask the borrower to submit quotation from reputed suppliers. The fixed asset would consist of the following:

(i) Land

(ii) Building

(iii) Plant and Machinery

(iv) Furniture and Fixture

(v) Information Technology

(i) **Land:** For almost all cases, land would not be financed by the term lender. So term lender would first ask the borrower to submit the land documents. In case land has not been purchased, the lender would not disburse the fund unless proof of land purchase has been shown to the lender by the borrower.

(ii) **Building:** In the case of a project where building has to be constructed, the lender would ask the borrower to submit detailed quotation for the building construction. Lender's engineer should verify the correctness of the quotation and the engineer should give written report in this regard. In case lender's engineer reduced the cost, the lender would communicate the same to the borrower and borrower has to accept this reduced quotations. While selecting the contractors for the construction of the building, the lender should ensure the following:

- The capacity of the contractor to execute such job
- The net worth of the contractor
- Past track record

(iii) **Plant and Machinery:** The borrower should submit multiple quotations and the lender should check the price of the equipment from the market. Lenders must also check about the following aspects of the plant and machinery:

- Suppliers credibility of the market
- Machines performance
- Comprehensive Maintenance Contract and its provisions
- Any adverse opinion of the machines being purchased in the recent periods

(iv) Furniture and Fixture: We shall adopt the same process as in the case of the building.

(v) Information Technology: In the case of IT, we shall take quotation from renowned vendors. It is advisable that at the time of first purchase, extended warranty period may be included in the quotations and the same to be included in the project cost.

Once we get all the price of the fixed assets, we determine the time of implementation. Since the implementation period would be spread over time period, the interest incurred during the construction period would be capitalized and the same would be included in the project cost. This interest is called Interest During Construction (IDC).

4.3 Margin Money for Working Capital

In the case of Margin Money for working capital or Net Working Capital calculation, we need to project the current assets. Margin money for working capital is a part of project finance. Without working capital project finance disbursement would not take place. Current asset should always be categorized into three parts:

- Inventory
- Receivable
- Other Current Asset

Inventory level may go up in the initial part of the project. Due to initial teething problem, inventory level would come down as the process stabilizes. This may not be true for receivable. Receivable level would go up in the initial stage if the product has competition in the market. For innovative product, receivable level may not go up in the initial phase. Receivable level may not go down subsequently. Holding level is important for calculation of appropriate working capital. Holding level should be based on a realistic situation. Lender should never assume constant current asset. It must determine the current asset from the holding level.

4.4 Evaluation of the project

When we decide for undertaking investment in a capital project, the following are the characteristics:

- Money is invested at a time i.e. out flow of fund takes place at a time;
- Inflow of fund is taking place at different points of time;
- So there is time value of money concept involved in analysing the capital investment decision since there is a considerable difference between the inflow and outflow of fund.

So any good project evaluation criteria must consider this time value of money. However, even today there are certain criteria which do not take into account the time value of money criteria. However, this type of evaluation must not be adopted.

Based on this, we are making a list of different evaluation criteria. The entire evaluation criterion is divided into two categories:

Category I (where time value of cash flow is not considered)

- Pay Back method
- Accounting Rate of return

Category II (where time value of cash flow is considered)

- Discounted Pay back
- Net Present Value
- Internal Rate of Return.

These techniques have already been discussed in greater detail in the paper Financial Management at Intermediate Level.

4.5 Issues related to Project /Infrastructure Funding

Project Financing is a new concept in India. Presently, not much of project financing happens in India except in the infrastructure sector. So issues related to infrastructure funding can be best methodology to analyse the appropriate assessment process of project funding.

Every infrastructure proposal should have the following sections:

- Technical Feasibility
- Financial Viability
- Bankability
- Risk Analysis
- Uncertainty Analysis

4.5.1 Technical Feasibility

Under this section technical feasibility of project is carried out through the Technical Feasibility Report broadly containing following heads:

- Approved technical consultant
- Coverage area:
  - Use of technology in previous project
  - Remaining life cycle of technology
- Risks associated with advent of newer technology
  - Any negative impact of the technology on the environment

  - Ease of availability of the technology during the operation of the project
- Forecasting area:
  - Sales / revenue prediction
  - Methodology of sales/revenue prediction
  - Approval status of the same with the regulatory / other bodies
- Past track record:
  - Back testing of projections and actual
  - Acceptability criteria

4.5.2 Financial Viability

Under this section, the viability of the project is carried out. RBI said that bankers should follow the following methods:

- Discounted Pay Back
- Internal Rate of Return
- Net Present Value
- Adjusted Present Value

Bankers can also follow more advanced methods of evaluation.

Adjusted Present Value (APV): As mentioned earlier first three methods are covered in the paper of Financial Management at Intermediate Level. Let us discuss the APV method here.

Normally financing decisions and investment decisions are handled separately. Since level of gearing adopted by a firm can influence the decision, APV technique offers some advantages over NPV. Accordingly, at the side effect of financing is also considered along with investment decision and accordingly formula for evaluation shall be as follows:

APV = Base NPV + Present Value of Impact of Financing

or NPVg = NPVu + PV of tax relief on debt interest

Where, NPVu = Value of ungeared company

Thus, it evaluates the NPV from the perspective of an geared company giving the increase in Vu by considering the benefit to the company of increasing the debt for its funding.

Illustration

XYZ Ltd. is planning to introduce a new product. The initial investment required is ₹ 48 lacs. Total requirement of ₹ 48 lacs will be met by, ₹ 8 lacs from internally generated funds, ₹ 15 lacs from a right issue and remaining from a long-term loan at 12% p.a. The ratio of loan reflects debt capacity of the company. Corporate taxes are payable at 40% p.a. on net operating cash flows of the particular year. Risk free rate of interest is 9%, market return is 14% and relevant company assets beta for the investment is estimated to be 1.5. Net operating after tax cash flows from the project is

year 1 = ₹ 15 lacs.

year 2 = ₹ 34 lacs;

year 3 = ₹ 12 lacs.

Besides, these inflows residual value of ₹ 5 lacs (after all taxes) is also expected at the end of third year. Assuming the principal is repayable at the end of 3 years you are required to estimate APV (Adjusted Present Value) of the investment and decide whether the investment is worth undertaking.

Solution

Base NPV:

This is applicable if the project is 100% equity financed.

$R_f + (R_m - R_f)\ \beta$

$= 9\% + (14\% - 9\%)\ 1.5 = 16.5\%$

NPV at Cost of Capital of 16.5% = ₹ (2.4840) lacs

Impact of Financing:

Annual Interest ₹ 25.00 lacs × 0.12 = ₹ 3.00 lacs

Annual Tax Saving = ₹ 3.00 lacs x 0.40 = ₹ 1.20 lacs

Present Value of Tax Shield

= ₹ 1.20 lacs × 3 year annuity factor of 12%

= ₹ 1.20 lacs × 2.4018

= ₹ 2.882 lacs

Adjusted Present Value

	₹ lac
Base NPV	(2.484)
Present Value of Impact of Financing	2.882
	0.398

The project is therefore marginally acceptable on the basis of APV.

4.5.3 Bankability of Project

Bankability means the repayment capacity of the borrower. Bankability is measured by way of:

- Debt Service Coverage Ratio
- Interest Service Coverage Ratio

4.5.4 Risk Analysis

Under this the following risks may be covered:

- Construction Risk:
- Post construction Risk:

4.5.4.1 Construction Risk

Construction carries the risk that the project will not be completed on time, within budget or at all because of technical, labour, and other construction difficulties.

- Delay in repayment
- Loss of sale contract

Construction Risk Mitigants:

- Past track record of the construction agencies
  - Minimum Net worth
  - Minimum Turn Over
  - Successful past experience
- Obtaining completion guarantees requiring the sponsors to pay all debts and liquidated damages if completion does not occur by the required date.
- Ensuring that sponsors have a significant financial interest in the success of the project so that they remain committed to it by insisting that sponsors inject equity into the project.
- Requiring the project to be developed under fixed-price, fixed-time turnkey contracts by reputable and financially sound contractors whose performance is secured by performance bonds or guaranteed by third parties.
- Obtaining independent experts' reports on the design and construction of the project.
- Phased draw- down
- Contingent on completion of milestone
- Milestones to be verified by:
  - Independent consultant

  - Government bodies
  - Other bodies

4.5.4.2 Post Construction Risk

- The risk here is that for a mining project, rail project, power station or toll road, there are inadequate inputs that can be processed or serviced to produce an adequate return.
- For example, there is the risk that there are insufficient reserves for a mine, passengers for a railway, fuel for a power station or vehicles for a toll road.

Post Construction Risk Mitigants:

- Experts' reports as to the existence of the inputs (e.g. detailed reservoir and engineering reports which classify and quantify the reserves for a mining project) or estimates of public users of the project based on surveys and other empirical evidence (e.g. the number of passengers who will use a railway);
- Requiring long term supply contracts for inputs to be entered into as protection against shortages or price fluctuations (e.g. fuel supply agreements for a power station);
- Obtaining guarantees that there will be a minimum level of inputs (e.g. from government that a certain number of vehicles will use a toll road);
- “Take or pay" off-take contacts which require the purchaser to make minimum payments even if the product cannot be delivered.
- Affect the cash-flow of the project by increasing the operating costs or affecting the project’s capacity to continue to generate the quantity and quality of the planned output over the life of the project.
- Operating risks include, for example, the level of experience and resources of the operator, inefficiencies in operations or shortages in the supply of skilled labour.
- Before lending :
  - To be operated by a reputable and financially sound operator whose performance is secured by performance bonds.
- During the loan period :
  - Provision of detailed reports on the operations of the project
  - Controlling cash-flows by requiring the proceeds of the sale of product to be paid into a tightly regulated proceeds account to ensure that funds are used for approved operating costs only.
- Market risk is the risk that a buyer cannot be found for the product at a price sufficient to provide adequate cash-flow to service the debt.

- Risk Mitigants:
  - The best mechanism for minimizing market risk before lending takes place is an acceptable forward sales contact entered with a financially sound purchaser.
- Uncertainty Analysis: Uncertainty is captured by way of:
  - Sensitivity Analysis
  - Scenario Analysis
  - Simulation
  - Decision Tree Analysis
  - Real Option Analysis

For projects where completion uncertainty is not there, we can use Sensitivity Analysis or Simulation Analysis. However, if the project has uncertainty, we have to use Decision Tree Analysis and Real Option analysis along with the above methods.

5. WORKING CAPITAL MANAGEMENT

Before we discuss the assessment of working capital, let us first understand the meaning and implication of the term "working capital". "Working Capital" consists of two words **"Working** "and **"Capital ".** As the name suggests, the meaning of working capital is the capital or fund required for working of the business. It is the fund required for day- to- day operations of the company. So in order to understand the requirement of working capital, we need to understand why we require funds for day- to- day operations.

Day-to-day operations mean purchasing goods and services and processing the same for production of goods and services and then selling the same. As we have discussed in the paper of Financial Management, first the organization has to purchase goods and services, then it processes the same, offer that it sells and then it collects the payment.

Hence, organization incurs expenses for the first and second stage. However, it collects cash in the fourth stage. So expenses incurred in the first and second stage need to be funded which requires working capital. Let us explain with the help of a simple example of a trading company.

Example

On 12th April 2013, a trader purchases material worth ₹ 25 lacs. It has incurred expenses on 12th April 2013. It has to make the payment if the supplier is not giving any credit. So if it does not get credit from the market, it requires working capital.

Next, if it sells on 12th April 2013, it gets cash on the same day and from this it can make the payment. So even though a person is purchasing raw material on cash basis and if he sells on cash basis, depending on the time of payment, he may not require working capital. If the customer sells on 15th April 2013 for one month credit, it would get the cash on 15th May 2013 and if it has to make the payment on 12th April 2013, it requires working capital for a longer period.

From the example, it is clear that the working capital requirement arises due to incurring expenses and making the payment on account of expenses before realization of cash from sales. After understanding the meaning of working capital, we shall now bring the definition of working capital.

5.1 Gross Working Capital Concept

According to this concept, a company's investment in total current assets signifies the Working Capital. So, Gross working capital is equal to total current assets.

The Gross Working Capital can be ascertained as follows:

Current assets		
(a)	Current investments	XXX
(b)	Inventories	XXX
(c)	Trade receivables	XXX
(d)	Cash and cash equivalents	XXX
(e)	Short-term loans and advances	XXX
(f)	Other current assets Gross Working Capital	XXX
Gross Working Capital		XXX

5.2 Net Working Capital Concept

According to this concept current assets minus current liabilities is known as Working Capital. If nothing is given generally it is taken as net working capital.

However, it may be noted that Net Working Capital means that part of Wording Capital gap which is financed with long term funds.

So, Net working Capital = Current Assets – Current Liabilities – Bank Borrowings for Working Capital.

The Net Working Capital are ascertained as follows:

Current assets		
(a)	Current investments	XXX
(b)	Inventories	XXX
(c)	Trade receivables	XXX
(d)	Cash and cash equivalents	XXX
(e)	Short-term loans and advances	XXX

(f) Other current assets	XXX
Gross Working Capital	XXX
Less: Current liabilities	
(a) Short-term borrowings	XXX
(b) Trade payables	XXX
(c) Other current liabilities	XXX
(d) Short-term provisions	XXX
Net Working Capital	XXX

5.3 Positive and Negative Working Capital

When current assets exceed current liabilities, a positive Working Capital is created, and when current assets are less than current liabilities, a negative Working capital occurs. The chronic negative working capital situation will lead to closure of business and the enterprise is said to be '*technically insolvent*'.

5.4 Factors Determining Working Capital Requirement

There is no set of universally applicable rules to ascertain working capital needs of a business organization. The factors which influence the need level are discussed below:

1. Time span required for conversion of raw materials into finished goods is a block period. The period, in reality, extends a little before and after the WIP. This cycle determines the need for working capital.

2. Credit policy of the business organization includes to whom, when and to what extent credit may be allowed. Amount of money locked-up in account receivables has its impact on working capital.

3. If we look at the balance sheet of any trading organization, we find that major quantum of the resources is deployed on current assets, particularly stock-in-trade. In contrast, service organizations need lesser working capital than trading and financial organizations. So working capital requirement depends on the nature of business.

4. Economic boom or recession etc., have their influence on the transactions and, consequently, on the quantum of working capital required.

5. If demand for a product is seasonal, then also manufacturing operation has to be conducted during the whole year resulting in working capital blockage during off season.

6. Operational level determines working capital demand during a given period. Higher the scale, higher will be the need for working capital.

7. It depends on the policy of the firm at which level of Stock turnover ratio they feel comfortable.

8. Creditworthiness is the precondition for assured accessibility to credit. Accessibility in banks depends on the flow of credit i.e., the level of working capital.

9. In case of newly established concerns, the materials are required to be purchased in cash and the sales are to be made on credit basis. But the established companies can negotiate for credit terms with suppliers and sell the product at shorter credit period to customers. Therefore, it requires less working capital than concerns with lesser business standing.

10. Growth and diversification of business call for larger volume of working fund. Working Capital needs are assessed in advance with reference to business plan.

11. In a buyers' market i.e. the market with fierce competition, the companies are forced to sell on credit, with liberal credit and collection policies. But if the sellers' market prevails, quick disposal of stocks, high percentage of cash sales, strict credit and collection policies etc. reduce the need for working capital.

12. Political stability brings in stability in money market and trading world. Things mostly go smooth. Risk ventures are possible with enhanced need for working capital finance. Similarly, availability of local infrastructural facilities like road, transport, storage and market etc., also influence business and working capital needs.

5.5 Assessment of Working Capital from the bank's point of view

After understanding the fundamental concept of the working capital and the meaning of different terminology of working capital, it is now easy to find out the step by step process of assessment of working capital.

1. *Step 1*: Understanding the meaning of 'assessment': In financial parlance, assessment means determination of quantum. So assessment of working capital means how much working capital is required by the company. When we are talking about the word 'assessment' from the bank's point of view, we mean the amount bank would sanction as working capital limit. Henceforth, we shall talk of assessment from the bank's point of view only.

2. *Step 2*: Assessment means future requirement of fund. So assessment would be carried out on the basis of future financials. When we talk about the future we are talking about the current running year (estimate) and the next year (projected). So assessment would be carried out either on the basis of estimated figure or projected figure. However actual is required to find out the present position of the borrower and the validation of the projection.

3. *Step 3*: Determination of assessment methodology. In India, fund based working capital assessment is carried out by three methods:

(a) **Turn Over Method:** Under this method, the sales are estimated or projected. Based on the projected or estimated sales, 25% of the projected sales is the working capital requirement. The underlying assumption of this method is that working capital cycle of the borrower is 90 days and in a year it would be rotated four times. Accordingly, working capital requirement (not the limit) is 25% of sales. Turnover method also says that 5% of the sales would be the net working capital. The limit would be 20% of the sales. This is also called Nayek Committee method of assessment of fund based working capital. This is explained with the help of an example:

Example

The actual sales of a company for the FY 2012-13 are ₹ 150 lacs and the actual bank borrowing for working capital as on March 31, 2013 is 25 lacs. The company has estimated sales of ₹ 200 lacs for the FY 2013-14 and the bank has accepted that estimate. Now, the working capital requirement of the company is ₹ 50 lacs i.e. 25% of ₹ 200 lacs. The minimum margin money is 5% of sales i.e. ₹ 10 lacs. We now shall look at the audited (provisional) figure of March 31, 2013. We find that as on March 31, 2013, the current asset is ₹ 40 lacs and the current liability as on that date is ₹ 33 lacs, the company is having actual net working capital of ₹ 7 lacs. The fund- based working capital limit would be ₹ 40 lacs provided the company brings in additional ₹ 3 lacs [₹ 10 lacs – ₹ 7 lacs]. If the company brings in additional ₹ 3 lacs, the fundbased working limit would be increased from ₹ 25 lacs to ₹ 40 lacs.

(b) **Maximum Permissible Bank Finance Method (MPBF):** Under this method, the borrower has to submit the data as per a specified format called Credit Monitoring Arrangement (CMA). As per this format, borrower has to fill up six forms called CMA form.

Form I of CMA forms requires that borrower provide details of the borrowing as on the date of the application.

Form II deals with the P&L.

Form III deals with the balance sheet.

In Form II and Form III, borrower has to provide four years' data, i.e. last two years' actual (audited /provisional), current year estimate and next year's projections.

While filling up Form II and Form III the borrower needs to adjust certain thing from the audited financials. These are given below:

1. The total sale value has to be segregated into domestic and export sales, with excise to be shown separately in Form II.
2. The consumption of raw material has to be segregated into import and inland part in Form II.
3. With the bank borrowing for working capital, bill discounting amount (which would appear as contingent liability on the borrower's balance sheet) would be added in the liability side under the head bank borrowing for working capital and in the asset side under the head receivable.

4. The current maturity of term loan would appear under the head current liability.
5. The unsecured loan would appear as term liability if it is payable more than 1 year and if it is not subordinate. In case it is subordinate, it may be treated as quasi-equity.
6. The receivable would have to be shown separately as export and domestic receivable. Receivable of more than 3 months and in some cases more than 6 months would be shown under the head current asset.
7. Loans and advances not related to production i.e. loans and advances to group companies would not be treated as current asset; it would be put under non- current asset.
8. Investment would be put under non- current asset.
9. Once Form III has been filled up, forms IV, Form V and Form VI would be automatically generated. Form III is the balance sheet of the borrower.
10. Form IV deals with the current asset and other current liability part. In this form, we have the amount as well as the holding level of Inventory, receivable and creditor.
11. Form V deals with assessment.
12. Form VI deals with the fund flow statement showing the sources and uses of fund.

Rules for making projections

The current asset is projected in a manner so that holding level of inventory, receivable and other current asset should not go up. The other current liability is projected in a manner so that the holding level of the creditor and other current is not going down. In case there is a deviation, it needs to be properly explained.

Once the projection is made, the assessment is carried out mainly by two methods namely Method I and Method II.

Under Method I, the limit has been arrived at by using the following sequence:

1. Estimated Current Asset : ₹ 100 lacs
2. Estimated Other Current Liability : ₹ 30 lacs
3. Estimated Working Capital Gap : ₹ 70 lacs
4. Minimum Net Working Capital (25% of Working Capital Gap) : ₹ 70 lacs*25% i.e. ₹ 17.5 lacs
5. Estimated net working capital is ₹ 18 lacs
6. MPBF is minimum of [3-4, or 3-5] i.e. 52 lacs

Under method II, the calculation is carried out in the following sequence:

1. Estimated Current Asset : ₹ 100 lacs
2. Estimated Other Current Liability : ₹ 30 lacs
3. Estimated Working Capital Gap : ₹ 70 lacs
4. Minimum Net Working Capital (25% of Current Asset) : ₹ 100 lacs*25% i.e. ₹ 25 lacs
5. Estimated net working capital is ₹ 25 lacs
6. MPBF is minimum of [3-4, or 3-5] i.e. 45 lacs

(c) **Cash Budget Method:** This is the most complex but most scientific method. In this method, the next two years' cash budget is forecasted under revenue account and capital account. The revenue deficit amount would be bridged by the capital account surplus and the remaining amount is the fund based limit. In the case of seasonal industry, this is the best method of assessment of fund based working capital. Besides, for construction and software the RBI is advising the banks to follow cash budget method of assessment.

Please note that if the assessment is carried out as per turnover or cash budget method, filling up of CMA form is not required by the borrower. In the case of cash budget, the borrower has to prepare a cash budget for the next 12 months.

6. REVERSE MORTGAGE

A Reverse Mortgage is meant for asset rich but cash poor senior citizens. A reverse mortgage is a loan available to homeowners, 60 year or older, that allows them to convert part of the equity in their homes into cash. A reverse mortgage is a type of mortgage in which an owner of a house can borrow money against the value of his home. The owner can receive money in the form of fixed monthly payment or a line of credit.

In India it is the National Housing Bank (NHB), who formulated the basic structure of this financial product. In a regular mortgage, the borrower takes loan from the bank and gives his property to the bank against collateral. Thereafter, he returns the loan amount by paying the principal and interest amount to the bank at regular intervals, say monthly.

However, reverse mortgage works in a different way. Here, the homeowner gives his property to the bank and receives payment based on the percentage of the value of the home. Payment may be received either in lumpsum cash, regular monthly cash payment, a line of credit (where the homeowner decides when and how much to borrow), or a combination of these options.

Further, throughout the life of the reverse mortgage, one can keep title to his home, which acts as a collateral for the loan.

The payout is generally for a fixed term of 15-20 years, after which the borrower or legal heirs (on death) can release the house by either repaying the loan or the company settles the amount by selling the house. Any excess in the process is paid to borrower or legal heirs as the case may be.

Now, let us understand who can opt for Reverse Mortgage. Only a senior citizen (60 years or above) who owns a residential property can opt for this product. If a couple is opting for the loan jointly, one of them should be a senior citizen and the other at least 55 years old. Further, while calculating the amount, the bank considers the following factors:

(i) Age,

(ii) Value of the property,

(iii) Current interest rates and the specific plan chosen.

(iv) Also, the residual life of the property should be at least 20 years.

The maximum monthly payment under Reverse Mortgage Loan (RML) is capped at ₹50,000, and the maximum lump sum payment will be 50% of the total eligible amount of loan with a cap of ₹15 lakh. Moreover, the borrower will have to continue paying all the taxes related to the house, insure it and take proper maintenance of the property.

The valuation of property is generally done at periodic intervals by the bank. Currently, big nationalized banks and some private banks offer reverse mortgage loans. Interest rate on these loans is usually in the range of 2.75-3% above the base rate.

There are two variants of RML available

(i) Regular RML

(ii) and, reverse mortgage loan-enabled annuity (RMLeA).

6.1 Regular RML

In case of regular RML, the homeowner will either get a lump sum amount or instalments depending on its frequency. It is similar to loan against property, the difference being that in RML, there is no need to pay back the money at the end of the tenure. For example, if the tenure of the loan is 20 years, the bank will stop paying money at the end of the tenure. There is no need to repay the loan amount during the lifetime or until one lives in the house.

RMLeA is a reverse mortgage backed with annuities and hence it works like a pension product that pays for lifetime. If you opt for RMLeA, you will get the money from a life insurer as the lender gives the loan amount to an insurance company. The insurer then annuitises the corpus and gives you pension money for the rest of your life.

6.2 RMLeA and its superiority to RML

In a regular RML, lender will make a payout till the end of the tenure.

In RMLeA, the actual loan to be disbursed is comparatively lower at 60-75% depending on the borrower's age. Here, the lender makes a one-time payment to an insurer. The insurer works out a monthly payment based on actuarial calculation that it will pay for life. Generally, annuities are offered at an interest rate of 6% a year. The payout in RMLeA is much higher than RML.

6.3 Risks associated with Reverse Mortgage

The main risks associated with Reverse Mortgage for lenders are as follows:

(1) If the person lives for longer life, then for bank it would be quite difficult to source long term funds to match with asset's value.

(2) Drop in the value of assets is another major risk.

(3) Interest Rate Risk is also a major risk as spread may become narrow.

(4) Legal risk is also attached with property as property may not be put to sale due to any legal reasons.

6.4 Reasons for failure of Reverse Mortgage to takeoff in India

(1) Tendency of Indians to treat their property as family heritage and the property is sold only as a last resort.

(2) Property owners also seen as an important people in the society.

(3) Senior Citizens who own property are assured of love and respect from their kins.

(4) There is no guarantee of life time income which most senior citizens consider in their retired life.

(5) As soon the term of the loan is over, the liability of repayment arises. Therefore, if someone who sustained the entire term of say, 20 years, he runs the risk of losing the house if he is not able to repay the loan.

(6) There is lack of awareness among the people regarding Reverse Mortgage Loans.

CHAPTER 9

MUTUAL FUNDS

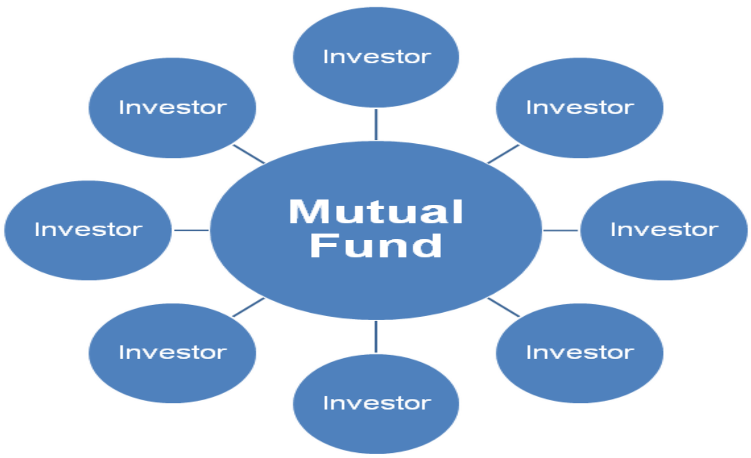
LEARNING OUTCOMES

After going through the chapter student shall be able to understand

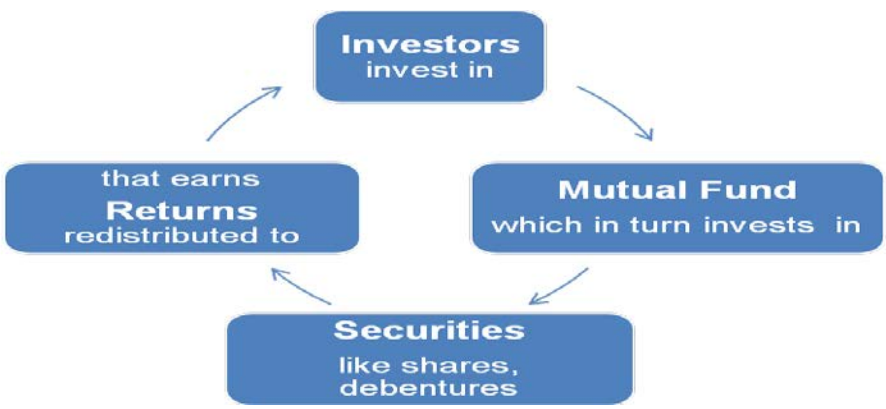
- Basics of Mutual Funds- Including its concepts and benefits etc.
- Evolution of the Indian Mutual Fund Industry
- Types of Mutual Funds
  - (1) Structural Classification
  - (2) Portfolio Classification
- Evaluating performance of Mutual Funds
  - (1) Net Asset Value (NAV)
  - (2) Costs incurred by Mutual Fund
  - (3) Holding Period Return (HPR)
- The criteria for evaluating the performance
  - (1) Sharpe Ratio
  - (2) Treynor Ratio
  - (3) Jensen's Alpha
  - (4) Sortino Ratio
- Advantages and Disadvantages of Mutual Fund
- Factors influencing the selection of Mutual Funds
- Signals highlighting the exit of the investor from the Mutual Fund Scheme
- Money Market Mutual Funds (MMMFS)
- Exchange Traded Funds
- Real Estate Investment Trusts (ReITs)
- Infrastructure Investment Trusts (Invits)

1. MEANING

A Mutual Fund is a pool of funds from a diverse cross section of society, that impart the benefits of scale and professional management to the investors, which otherwise would not have been available to them. The rationale for any pooling of service is two-fold: affordability and convenience. Office commuters can go to office by own vehicle or taxi cab, which is the synonym for do-it-yourself in the context of investments. The other way of doing the office commute is by public transport like bus or train, which essentially is the pooling concept, bringing transport within the reach of those people who cannot afford an own vehicle. The synonym here is the Mutual Fund. To be noted, it is not just affordability due to which people may take to public transport; there could be reasons like saving the hassles of maintaining and driving own vehicle. The other benefit in the mutual fund context is professional management and tracking of investments.



The diagram above illustrates that a mutual fund is a common pool of investments of a cross section of investors. To understand the concept better, please look at the following diagram:



A Mutual Fund is a pool of investment funds of a number of investors who have a common investment objective. The asset management company, that manages the day-to-day running of the fund, invests the money collected in securities like stocks, bonds etc. The investors, called unit-holders as they hold units in the pool proportionate to their investment, earn from the appreciation in the investments and dividend / coupon received in the fund. Thus a Mutual Fund is the most suitable investment for the common man as well as HNIs since it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

2. EVOLUTION

2.1 History of Mutual Funds (Global)

A mutual fund, as the term suggests, is a pooling of resources of many investors and is managed by professionals. The concept of pooling money for investments has been there for a long time. It began in the Netherlands in the 18th century; today it is a growing, international industry with fund holdings accounting for trillions of dollars in the United States alone. The closed-end investment companies launched in the Netherlands in 1822 by King William I is supposedly the first mutual funds. Another theory says a Dutch merchant named Adriaan van Ketwich whose investment trust created in 1774 may have given the king the idea. The concept spread to Great Britain and France, and then to the United States in the 1890s.

2.2 Expansion

By the late 1920s, there were quite a few mutual funds in the USA. With the stock market crash of 1929, some funds were wiped out, particularly the leveraged ones. The creation of the Securities and Exchange Commission (SEC), and the Securities Act of 1933 put certain safeguards for investor protection.

Despite the global financial crisis of 2008-2009, the story of the mutual fund is far from over. In fact, the industry is still growing. In the U.S. alone there are more than 10,000 mutual funds and fund holdings are measured in the trillions of dollars.

2.3 History of Mutual Funds in India

The evolution of the mutual fund industry in India has been relatively more 'administered' i.e. there have been quite a few administrative interventions. The history, as delineated by AMFI, is as follows:

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. The history of mutual funds in India can be broadly divided into four distinct phases:

2.3.1 First Phase – 1964-87

Unit Trust of India (UTI) was established on 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had ₹ 6,700 crore of assets under management.

2.3.2 Second Phase – 1987-1993 (Entry of Public Sector Funds)

1987 marked the entry of non- UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non- UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. At the end of 1993, the mutual fund industry had assets under management of ₹ 47,004 crore.

2.3.3 Third Phase – 1993-2003 (Entry of Private Sector Funds)

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996.

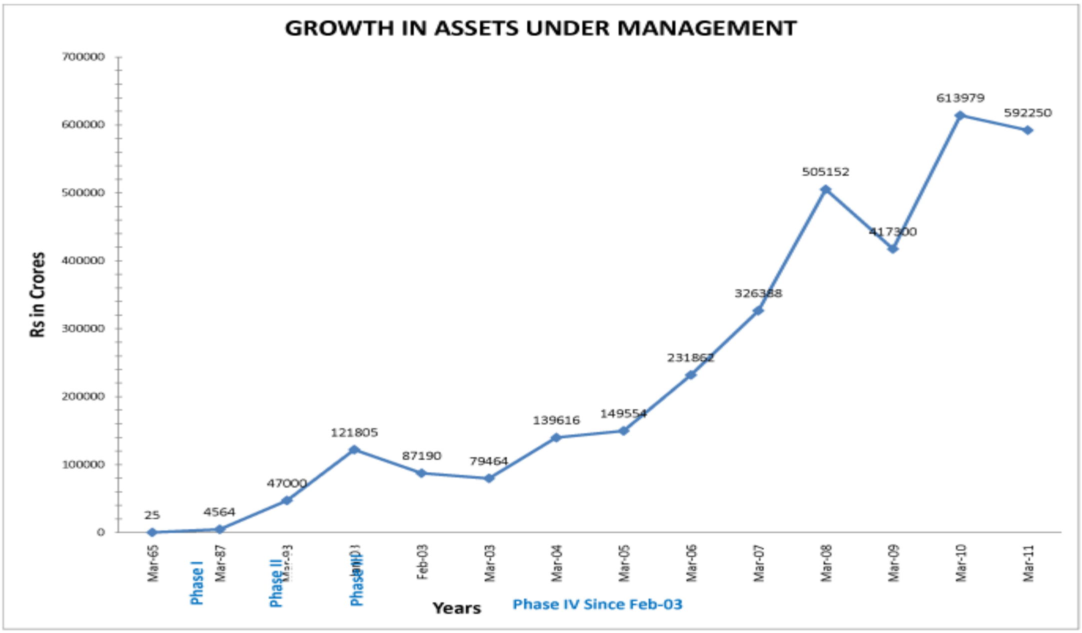
The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of ₹ 1,21,805 crore. The Unit Trust of India with ₹ 44,541 crore of assets under management was way ahead of other mutual funds.

2.3.4 Fourth Phase – since February 2003

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of ₹ 29,835 crore as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

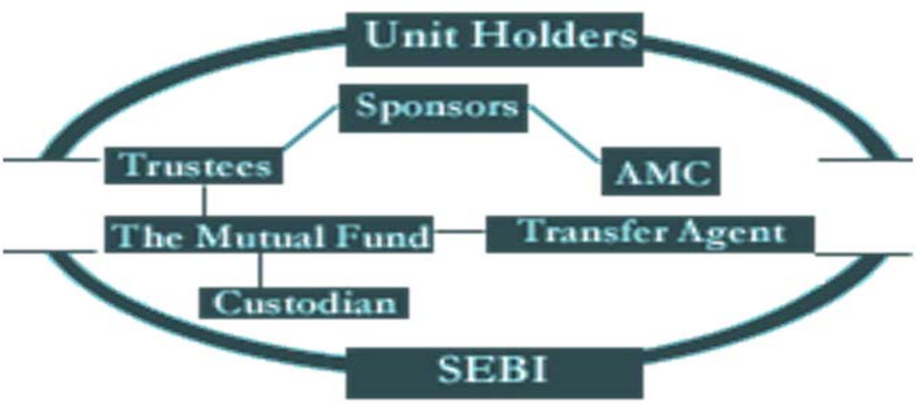
The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than ₹ 76,000 crore of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth

Growth in terms of quantum of funds managed



Source: AMFI

2.4 Mutual Fund Organization



There are various entities involved in the overall structure. They are explained as below:

Sponsor

Sponsor is the entity that creates a mutual fund. The rules are set by the Securities and Exchange Board of India, in the Mutual Fund Regulations of 1996.

Trust

The Mutual Fund is a trust under the Indian Trusts Act, 1882. The trust deed is registered under the Indian Registration Act, 1908. The Trust oversees the safekeeping of the unit-holders' investments.

Trustee

The Board of Trustees i.e. the body of individuals, looks after the safeguarding the interest of the unit holders. At least 2/3rd of the Trustees are independent i.e. not associated with the Sponsor.

Asset Management Company (AMC)

The AMC is the piece of the mutual fund system that looks after the operations and investments of the MF. Formation of the AMC requires approval by SEBI. The AMC needs to have a net worth of ₹ 50 crore.

3. TYPES OF MUTUAL FUNDS

There are various types of mutual funds, classified primarily on the basis of underlying portfolio.

3.1 On the basis of Structure

3.1.1 Open Ended Funds

It is a commonly used term in the mutual fund industry; let us understand the term for the investor. Most of the funds (or Schemes, technically) are open ended, ones that are available for purchase from the AMC and redemption with the AMC on an on-going basis, round the year on all working days, till it is wound up. What it means for the investor is, there is liquidity round the year - can be purchased anytime and can be sold (redeemed, technically) anytime. Listed open ended funds can be sold at the Exchange as well, but in case of redemption with the AMC, liquidity is assured. There is no additional cost for this liquidity as AMCs do not charge any premium for redemption.

Sometimes there is an exit load in an open ended fund. It means if the investor exits within that period, there will be a penalty charged on the exit value, but liquidity is available nonetheless though at the cost of the exit load. It is a matter of discipline so that the investor comes in with the requisite horizon in mind and if he/she exits within that period, s/he pays adequate compensation to the other investors who are staying back.

The implication of open ended funds for the AMC is fund (or Scheme) corpus size volatility; fund size increases when investors purchase units from the AMC and fund size comes down when investors redeem units.

An open ended fund comes into existence through the New Fund Offer (NFO) process and the Fund (or Scheme) parameters are decided by the NFO documents - Scheme Information Document (SID) and Key Information Memorandum (KIM). There is another document called Scheme Additional Information (SAI).

There is no defined maturity date for open ended funds; as long as there is a single investor, the Scheme continues to be in existence. There are limitations on maximum holding by a single investor: it is referred to commonly as the 20/25 rule - there has to be minimum 20 investors to float a Scheme and maximum permissible holding per investor is 25%.

3.1.2 Close Ended Funds

Close ended funds are available for subscription only during the New Fund Offer (NFO) period and not beyond that. The initial subscription amount is collected from investors and the fund is 'closed' after the NFO closure date i.e. no further purchase is allowed. There is no redemption possible with the AMC. Hence from the AMC's perspective, the fund (or Scheme) corpus size is stable and there is no need to manage 'liquidity' in the fund no need to keep some portion in liquid or easily marketable securities to meet sudden redemption pressure.

Close ended funds may have a defined maturity date e.g. fixed maturity plans (FMPs) that have a maturity date. In an open-ended structure, it is practically not feasible to have a maturity date as it is meant to be available for investment and redemption on an on-going basis. Close ended funds are listed at the Exchange, but are not as liquid as open ended funds as there is no defined liquidity like redemption with the AMC.

Broadly, open ended funds are much more popular than close ended as the fund industry is supposed to provide investment solutions along with liquidity that it available at any point of time. Close Ended Funds are meant to fulfil a particular requirement.

3.2 On the basis of Investment Portfolio

The Schemes would be broadly classified in the following groups:

a. Equity Schemes

b. Debt Schemes

c. Hybrid Schemes

d. Solution Oriented Schemes

e. Other Schemes

A. Equity Schemes:

Sr. No.	Category of Schemes	Scheme Characteristics	Type of scheme (uniform description of scheme)
1	Multi Cap Fund	Minimum investment in equity & equity related instruments – 65% of total assets	Multi Cap Fund – An open ended equity scheme investing across large cap, mid cap, small cap stocks
2	Large Cap Fund	Minimum investment in equity & equity related instruments of large cap companies – 80% of total assets	Large Cap Fund – An open ended equity scheme predominantly investing in large cap stocks
3	Large & Mid Cap Fund	Minimum investment in equity & equity related instruments of large cap companies – 35%of total assets Minimum investment in equity & equity related instruments of mid cap stocks – 35%of total assets	Large & Mid Cap Fund – An open ended equity scheme investing in both large cap and mid cap stocks
4	Mid Cap Fund	Minimum investment in equity & equity related instruments of mid cap companies – 65% of total assets	Mid Cap Fund – An open ended equity scheme predominantly investing in mid cap stocks
5	Small Cap fund	Minimum investment in equity & equity related instruments of small cap companies – 65% of total assets	Small Cap Fund – An open ended equity scheme predominantly investing in small cap stocks
6	Dividend Yield Fund	Scheme should predominantly invest in dividend yielding stocks. Minimum investment in equity – 65% of total assets	An open ended equity scheme predominantly investing in dividend yielding stocks
7	Value Fund*	Scheme should follow a value investment strategy.	An open ended equity scheme following a value investment strategy

		Minimum investment in equity & equity related instruments – 65% of total assets	
	Contra Fund*	Scheme should follow a contrarian investment strategy. Minimum investment in equity & equity related instruments – 65% of total assets	An open ended equity scheme following contrarian investment strategy
8	Focused Fund	A scheme focused on the number of stocks (maximum 30) Minimum investment in equity & equity related instruments – 65% of total assets	An open ended equity scheme investing in maximum 30 stocks (mention where the scheme intends to focus, viz; multi cap, mid cap, small cap)
9	Sectoral / Thematic	Minimum investment in equity & equity related instruments of a particular sector/ particular theme – 80% of total assets	An open ended equity scheme investing in - sector (mention the sector) An open ended equity scheme following – theme (mention the theme)
10	ELSS	Minimum investment in equity & equity related instruments – 80% of total assets (in accordance with Equity Linked Saving Scheme, 2005 notified by Ministry of Finance)	An open ended equity linked saving scheme with a statutory lock in of 3 years and tax benefit

For classification of companies as per market capitalization, the definition is as follows:

- Large Cap: 1st -100th company in terms of full market capitalization
- Mid Cap: 101st -250th company in terms of full market capitalization
- Small Cap: 251st company onwards in terms of full market capitalization

B. Debt Schemes:

Sr. No.	Category of Schemes	Scheme Characteristics	Type of scheme (uniform description of scheme)
1	Overnight Fund	Investment in overnight securities having maturity of 1 day	An open ended debt scheme investing in overnight securities
2	Liquid Fund	Investment in Debt and money market securities with maturity of upto 91 days only	An open ended liquid scheme
3	Ultra Short Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 3 months – 6 months	An open ended ultra – short term debt scheme investing in instruments with Macaulay duration between 3 months and 6 months
4	Low Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 6 months – 12 months	An open ended low duration debt scheme investing in instruments with Macaulay duration between 6 months and 12 months
5	Money market Fund	Investment in Money Market instruments having maturity upto 1 year	An open ended debt scheme investing in money market instruments
6	Short Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 1 year – 3 years	An open ended short term debt scheme investing in instruments with Macaulay duration between 1 year and 3 years
7	Medium Duration Fund	Investment in Debt & Money Market instruments such that the Macaulay duration of the portfolio is between 3 years – 4 years	An open ended medium term debt scheme investing in instruments with Macaulay duration between 3 years and 4 years

8	Medium to Long Duration Fund	Investment in Debt & Money market instruments such that the Macaulay duration of the portfolio is between 4 – 7 years	An open ended medium term debt scheme investing in instruments with Macaulay duration between 4 years and 7 years
9	Long Duration Fund	Investment in Debt & Money Market Instruments such that the Macaulay duration of the portfolio is greater than 7 years	An open ended debt scheme investing in instruments with Macaulay duration greater than 7 years
10	Dynamic Bond	Investment across duration	An open ended dynamic debt scheme investing across duration
11	Corporate Bond Fund	Minimum investment in corporate bonds – 80% of total assets (only in highest rated instruments)	An open ended debt scheme predominantly investing in highest rated corporate bonds
12	Credit Risk Fund	Minimum investment in corporate bonds – 65% of total asset (investment in below highest rated instruments)	An open ended debt scheme investing in below highest rated corporate bonds
13	Banking and PSU Fund	Minimum investment in Debt instrument of banks, Public Sector Undertakings, Public Financial Institutions – 80% of total assets	An open ended debt scheme predominantly investing in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions
14	Gilt Fund	Minimum investment in Gsecs – 80% of total assets (across maturity)	An open ended debt scheme investing in government securities across maturity
15	Gilt Fund with 10 year constant duration	Minimum investment in G secs – 80% of total assets such that the Macaulay duration of the portfolio is equal to 10 years	An open ended debt scheme investing in government securities having a constant maturity of 10 years

16	Floater Fund	Minimum investment in floating rate instruments – 65% of total assets	An open ended debt scheme predominantly investing in floating rate instruments

For debt funds, the classification is on the basis of Macaulay Duration, and not on the basis of Average Maturity of Modified Duration.

C. Hybrid Schemes:

Sr. No.	Category of Schemes	Scheme Characteristics	Type of scheme (uniform description of scheme)
1	Conservative Hybrid Fund	Investment in equity & equity related instruments – between 10% and 25 % of total assets; Investment in Debt instruments – between 75% and 90% of total assets	An open ended hybrid scheme investing predominantly in debt instruments
2	Balanced Hybrid Fund	Equity & Equity related instruments – between 40% and 60 % of total assets; Debt instruments – between 40% and 60% of total assets No arbitrage would be permitted in this scheme	An open ended balanced scheme investing in equity and debt instruments
	Aggressive Hybrid Fund	Equity & Equity related instruments – between 65% and 80% of total assets; Debt instruments – between 20% and 35% of total assets	An open ended hybrid scheme investing predominantly in equity and equity related instruments
3	Dynamic Asset Allocation or Balanced Advantage	Investment in equity / debt that is managed dynamically	An open ended dynamic assets allocation fund
4	Multi Assets Allocation	Invests in at least three asset classes with a minimum allocation of at least 10% each in all three asset classes	An open ended scheme investing in the three different asset classes

5	Arbitrage Fund	Scheme following arbitrage strategy. Minimum investment in equity & equity related instruments – 65% of total assets	An open ended scheme investing in arbitrage opportunities
6	Equity Savings	Minimum investment in equity & equity related instruments – 65% of total assets and minimum investment in debt – 10% of total assets Minimum hedged & unhedged to be stated in the SID	An open ended scheme investing in equity, arbitrage and debt

D. Solution Oriented Schemes:

Sr. No.	Category of Schemes	Scheme Characteristics	Type of scheme (uniform description of scheme)
1	Retirement Fund	Scheme having a lock – in for at least 5 years or till retirement age whichever is earlier	An open ended retirement solution oriented scheme having a lock – in of 5 years or till retirement age (whichever is earlier)
2	Children's Fund	Scheme having a lock – in for at least 5 years or till the child attains age of majority whichever is earlier	An open ended fund for investment for children having a lock – in for at least 5 years or till the child attains age of majority (whichever is earlier)

E. Other Schemes:

Sr. No.	Category of Schemes	Scheme Characteristics	Type of scheme (uniform description of scheme)
1	Index Funds / ETFs	Minimum investment in securities of a particular index (which is being replicated / tracked) – 95% of total assets	An open ended scheme replicating / tracking _index
2	FOFs (Overseas / Domestic)	Minimum investment in the underlying fund – 95% of total assets	An open ended fund of fund scheme investing in – fund (mention the underlying fund)

4. NET ASSET VALUE (NAV)

There is a valuation of the fund done at the end of every business day, so that the investor knows the value of his/her investments as on that date. The term 'value' here refers to the market value i.e. if hypothetically the entire portfolio were to be liquidated, how much would be realized. Since each investor holds units in the pool of funds, the valuation is published in terms of per unit, so that the value of one's holdings can be computed. The formula for computation of NAV is:

$$\text{NAV} = \frac{\text{Market Value of Investments held by the Fund + Value of Current Assets - Value of Current Liabilities and Provisions}}{\text{No. of Units on the valuation date before redemption or creation on units}}$$

The value at the end of the day is not only the market value of the investments as on that day - to the market value of the investments we have to add the cash equivalents or other current assets and need to deduct any expenses that have accrued but not paid out, so that the NAV represents a true and fair picture. That is the reason it is called 'net' asset value i.e. it is net of liabilities, expenses, etc.

NAV is published on every business day for all funds; for Liquid Funds, NAV is published on Sundays as well.

In equity funds, returns come mostly from price movement. Hence the differential in NAV between two dates is mostly the difference in market value of the investments

In debt funds, returns come mostly from interest accrual. Hence the differential in NAV between two dates is mostly the accrual, provided the period is sufficiently long to absorb short term volatilities.

5. PERFORMANCE MEASUREMENT

It comes as a statutory warning that "mutual fund investments are subject to market risks . . . past performance is not an indication of future performance". Very few people read it or understand the import of the statement. The implication of the statement is that, the performance we are looking at today, is the result of certain investment decisions taken by the fund manager in the past. The fund manager is ultimately a human being, and future decisions may or may not be as effective and hence future returns from that fund may or may not be as good.

Even though past performance may not be repeated in future, there is no logic to go for a Fund that has been an underperformer, because that particular fund manager could not prove himself / herself efficient over the period under consideration. The outperformer has something going for himself / herself. Hence, let us look at past performance also as a hygiene factor.

What should be avoided is,

- looking at past performance over a short period of time
- looking at returns only till a particular date and comparing the numbers
- basing a decision on a ranking system, ranked only by returns till a particular date.

Let us now understand why the above practices should be avoided.

A short period of time is not adequate to judge the performance of a fund manager, just like the runs scored or wickets taken by a cricketer over 5 matches is not enough to judge his class - at best it shows his current form. Similarly, if a bond fund is outperforming the peer group over a period of say 1 or 2 months, it may be that the calls (investment decisions) taken by the fund manager over 1 or 2 months have proved better than other fund managers and that's it. Fund managers who have proven himself / herself over a long period of time should be preferred.

Point to point returns till the date of review may be influenced by the outperformance / underperformance over the recent past. That is to say, if we are looking at 1 month, 3 month, 6 month and 1 year returns till the date of review, if that particular fund has done very well or very poorly over the last 1 month, it will influence the 6 month and 1 year returns as well. Hence returns at various intermittent periods are as relevant.

As discussed earlier, a Fund may have done well over say a 1 year period which makes it eligible for '5 stars' (performance ranking done by some agencies / websites) as against another Fund which is say '4 stars' or '3 stars' and you take the decision to invest in the 5 star rated Fund, it may not be an entirely correct decision. Nothing wrong about a fund doing well, more so if the performance-based ranking is over an adequate period of time and it is done on a 'risk-adjusted basis' i.e. adjusted for volatility in returns. The point is, there are certain 'hygiene factors' which should be considered. Lay investors would be attracted by the '5 stars' and would not be aware that a 5 star rated Fund may be low on the hygiene factors. For example, a Fund with a corpus of ₹ 1,000 crore from a leading AMC / sponsor with 4 star performance should be preferred over a 5 star rated Fund with a corpus of ₹ 20 crore which is from an AMC that ranks among the bottom 5 in terms of corpus / their sponsor is not so well known or if the credit quality of the Fund is relatively poor.

5.1 Performance Measures

There are various ways of measuring performance; what is most commonly used is looking at point to point returns (i.e. returns from one particular date to today's date) over various time periods e.g. 1 month, 3 month, 6 months, 1 year, 2 years, etc.

As a matter of regulation, returns from fixed income Funds for a period less than 1 year should be simple annualized and for a period more than 1 year it should be annualized on a compounded basis.

There are more refined methods of looking at point to point returns, which are

- looking at risk-adjusted (i.e. adjusted for volatility) returns
- looking at various statistical ratios e.g. Sharpe Ratio, Alpha Ratio, Treynor Ratio, etc.

5.1.1 Costs incurred by Mutual Fund

Costs when high reduce the returns of an investor. High Costs are the cause of below par performance of some mutual funds. Costs carry two components: (1) Initial Expenses attributable to establishing a scheme under a Fund and (2) Ongoing recurring expenses (Management Expense Ratio) which is made up of (a) Cost of employing technically sound investment analysts (b) Administrative Costs (c) Advertisement Costs involving promotion and maintenance of Scheme funds. The Management Expense Ratio is measured as a % of average value of assets during the relevant period.

Expense Ratio = Expense / Average value of Portfolio

If Expenses are expressed per unit, then Expense Ratio = Expenses incurred per unit / Average Net Value of Assets.

The Expense Ratio relates to the extent of assets used to run the Mutual Fund. It is inclusive of travel cost, management consultancy and advisory fees. It however excludes brokerage expenses for trading as purchase is recorded with brokerage while sales are recorded without brokerage.

5.1.2 Point to Point Returns

Point to point simply measures returns from a past date to the current date, by taking the NAV at these two dates. For measurement of returns, the growth option NAV should be taken and not the dividend option as there would be complications of adding back dividend. As an example, the return over one year from 31 December 2017 to 31 December 2018 is the increment in the growth option NAV divided by the NAV as on 31 Dec 2017.

Similarly, returns over three months from 30 September 2018 to 31 December 2018 is the increment in the growth option NAV divided by the NAV as on 31 December 2017. The return over three years from 31 December 2015 to 31 December 2018 is the increment in the growth option NAV divided by the NAV as on 31 December 2015. To be noted, returns from equity funds over a period of less than one year is expressed as absolute and for more than one year, it is annualized on a compounded basis. For fixed income funds for a period less than one year should be simple annualized and for a period more than one year it should be compound annualized.

5.1.3 Rolling Returns

The method to iron out the possible skew in point to point returns which may result from outperformance / underperformance in the recent past, is to look at rolling returns. Measurement of rolling returns works like this: over the period under consideration, take many short periods of fixed frequency, measure the return from the Fund over these shorter time periods, and take the average of all the data over the entire period.

Example of computation:

Performance of a Liquid Fund over a 3-month period:

- Point-to-point: simply measure the performance of the growth option NAV from the start date to today's date, annualized.
- Rolling return of daily frequency: measure the return from the start date to next date, from next to next-to-next date and so on, and take the average of all these observations.
- Rolling return of weekly frequency: measure the return from the start date to next week, from next week to next-to-next week and so on, and take the average of all these observations.

Performance of an Equity / Bond Fund over a 3-year period:

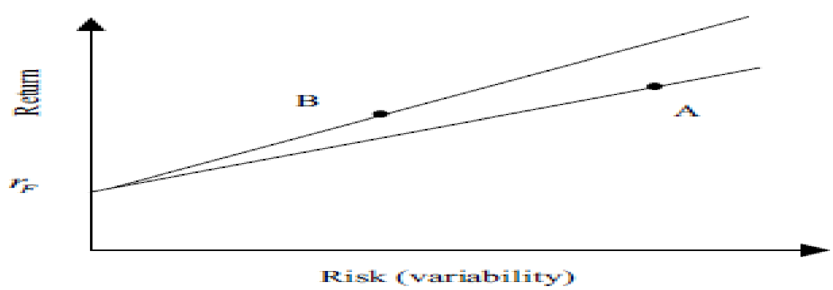
- Point-to-point: simply measure the performance of the growth option NAV from the start date to today's date, compound annualized.
- Rolling return of monthly frequency: measure the return from the start date to one-month-later date, from next to next-to-next month and so on, and take the average of all these observations.
- Rolling return of quarterly frequency: measure the return from the start date to three-month-later date, from next quarter to next-to-next quarter and so on, and take the average of all these observations.

The superiority of rolling return as a performance measurement over simple point-to-point return is that it irons out the various smaller pockets of outperformance and underperformance against the peer group and throws up a more dependable (smoothened out) data.

5.2 Statistical Ratios

5.2.1 Sharpe Ratio (Reward to Variability)

Investors prefer stocks or portfolios with relatively less risk or less volatility. Therefore, how do we evaluate portfolios with different returns and different levels of risk?



	Portfolio A	Portfolio B	Benchmark
Annualized return	7.9%	6.9%	7.5%
Annualized risk	5.5%	3.2%	4.5%
Sharpe ratio			
(Risk-free rate = 2%) $SR = \frac{r_P - r_F}{\sigma_P}$	$\frac{7.9\% - 2.0\%}{5.5\%}$ = 1.07	$\frac{6.9\% - 2.0\%}{3.2\%}$ = 1.53	$\frac{7.5\% - 2.0\%}{4.5\%}$ = 1.22

r_P is the portfolio return

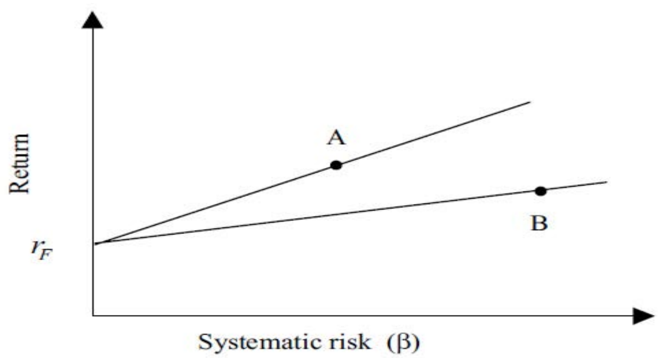
r_F is the risk-free rate

As we see in the table above, though the return as such of portfolio A (7.9%) is higher than portfolio B (6.9%) and Benchmark (7.5%), variability also is higher. The Sharpe Ratio of portfolio A (1.07) is much lower than portfolio B (1.53) and also lower than benchmark portfolio (1.22).

The higher the Sharpe ratio, the better because the portfolio has given that much higher return to compensate for the higher variability. The Sharpe ratio is a very popular method for measuring risk-adjusted return.

5.2.2. Treynor Ratio

The output of Treynor ratio is similar to Sharpe, the difference being that the denominator, instead of standard deviation in Sharpe, takes the systematic risk calculated by beta of the portfolio.



$$TR = \frac{r_P - r_F}{\beta_P}$$

The Treynor ratio measures excess return generated per unit of risk in the portfolio i.e. excess return earned above the risk-free investment. Treasury bills are usually taken as the proxy for risk-free return as it is issued by the Government and duration is not very long. Risk refers to the portfolio beta i.e. the extent to which the portfolio performance varies along with the relevant market.

5.2.3 Jensen's Alpha

This is the difference between a fund's actual return and those that could have been made on a benchmark portfolio with the same risk- i.e. beta. It measures the ability of active management to increase returns above those that are purely a reward for bearing market risk. Caveats apply however since it will only produce meaningful results if it is used to compare two portfolios which have similar betas.

Assume Two Portfolios

	A	B	Market Return
Return	12	14	12
Beta	0.7	1.2	1.0

Risk Free Rate = 9%

The return expected = Risk Free Return + Beta portfolio (Return of Market - Risk Free Return)

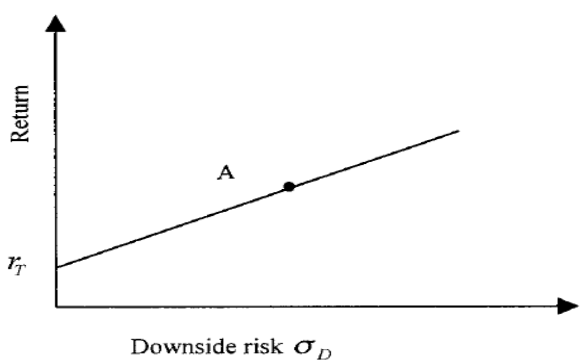
Using Portfolio A, the expected return = 0 .09 + 0.7 (0.12 - 0.09) = 0.09 + 0.021 = 0.111

Alpha = Return of Portfolio- Expected Return= 0.12 - 0.111 = 0.009

As long as "apples are compared to apples"- in other words a computer sector fund A to computer sector fund b- it is a viable number. But if taken out of context, it loses meaning. Alphas are found in many rating services but are not always developed the same way- so you can't compare an alpha from one service to another. However we have usually found that their relative position in the particular rating service is to be viable. Short-term alphas are not valid. Minimum time frames are one year- three year is more preferable.

5.2.4 Sortino Ratio

Sortino ratio is a variation of the concept of Sharpe or Treynor ratios; instead of measuring it against any type of risk, Sortino measures it against only downside risk in the portfolio.



$$SR = \frac{r_P - r_F}{\sigma_D}$$

Here,

σ_D is the standard deviation on the downside i.e. not just the entire deviations in the portfolio but the downside deviations only.

Sortino ratio penalizes only returns below a specified rate. Sharpe and Sortino measure risk-adjusted return, but they are different. Sortino ratio differentiates negative volatility from entire volatility by taking the standard deviation of negative returns, called downside, rather than total standard deviation.

5.2.4 Portfolio or Fund Alpha

The Alpha is the excess return over broad market, represented by the benchmark. Beta is the systematic return or return along with the market whereas Alpha is the return over and above the market generated by active fund management and by taking risks i.e. unsystematic risks. To gauge the excess return over the market, the index or benchmark is taken to represent the market return and the excess return over the index / benchmark is the Alpha. Alpha may be positive or negative i.e. active portfolio calls or portfolio churning can go either way.

5.2.5 Computation of statistical ratios

The measures discussed above, like Sharpe or Treynor ratio, is to be calculated by taking a series of growth option NAVs of the fund and that relevant values of the benchmark.

5.2.6 Benchmarking

For any performance evaluation, benchmarking is very relevant. Question is, what is the correct benchmark? In most literature on mutual funds and on communications from AMCs, the standard / official benchmark is mentioned. For example, for a large cap equity fund, the Nifty50 Index can be used or if it is a Short Term Bond Fund, the CRISIL index for Short Term Bond Funds (STBex) would be mentioned.

6. ADVANTAGES AND DISADVANTAGES OF MUTUAL FUND

6.1 Advantages

(i) **Professional expertise:** Except for some large corporate investors with dedicated treasury departments, it is not possible for an investor to replicate the expertise and professional fund management skills of MFs. The market is dynamic and portfolio reshuffling calls have to be taken as and when required. Active tracking of portfolio is not the job of the archetype investor.

(ii) **Operational / Transaction ease:** The process of buying and selling an instrument in the secondary market is quite cumbersome as compared to the process of investing / redeeming in MFs. For a similar / comparable return, the investor would rather settle for an easier process.

(iii) **Accessibility:** Mutual Funds are easy to access, through distributors, online, acceptance centers etc.

(iv) **Ticket Size**: All ticket sizes are available, from as small as ₹ 5000 to multiples of crores.

(v) **Liquidity:** In mutual funds, liquidity is just a redemption away. Nowadays, it can be done online and the money gets credited to your bank account. The time period for getting the credit depends on the nature and terms of the fund; it may be T+1 day to T+3 days.

(vi) **Option of multiple funds:** There are multiple categories of funds discussed earlier, there is one to suit your requirement, managed by professionals. That is not the case with direct investment in equity stocks / bonds.

6.2 Advantages typical of debt funds

(i) **Wholesale nature of the market:** The fixed income market, by nature, is wholesale. Unlike the equity market where both individuals and institutions participate, in the fixed income market, the participants are institutions like banks, insurance companies, etc. Deals are struck in multiples of ₹ 5 crore. This is not to say the minimum deal size is ₹ 5 crore, but to say that an individual with an investible corpus of say ₹ 10 lakh would not find a toehold in the fixed income market. Size / scale is of critical importance, which is possible only by pooling of funds, which, as discussed above, is the concept of MFs.

(ii) **Liquidity requirements:** Even if an individual is able to obtain an investible lot of say ₹ 10 lakh, when it comes to selling it to book profits or to obtain cash, it could be an issue. It takes time to find a buyer, given the wholesale nature of the market. Through the MF route, liquidity is just a redemption away, for the investor.

From an AMC perspective, all redemption requests may not result in a sale of an instrument in the secondary market. There are new investors coming in, and to the extent the amount is netted off, it does not require a market transaction. To clarify here, MFs do not operate as Ponzi Schemes to match redemptions with fresh investments - they invest in saleable securities. Only if fresh investments are coming in, it may not require selling an instrument from the portfolio.

(iii) **Tax Efficiency in growth option over 3 years:** In bonds, most of the returns come from coupons, which is taxable at the marginal slab rate i.e. 30% + surcharge and cess. Capital gains of bonds is a small component of returns. In mutual funds, if you have a horizon of 3 years, there is significant tax efficiency. You get the benefit of indexation for computation of long term capital gains tax, and the tax rate is 20% + surcharge and cess.

6.3 Disadvantages of Mutual Fund

(i) **Flexibility:** If you are running your own portfolio, you can run your own strategies. In mutual funds, you are following the fund manager.

(ii) **Alpha:** In developed markets like USA, there is a shift towards passively managed funds i.e. ETFs (discussed below) as there is not much of alpha generated over the broad market. ETFs run at a much lower cost than actively managed funds. While ETFs also are mutual funds, the point is, the alpha is missing in developed markets due to better information and efficiency in markets.

7. FACTORS INFLUENCING THE SELECTION OF MUTUAL FUNDS

(1) **Past Performance** – The Net Asset Value is the yardstick for evaluating a Mutual Fund. The higher the NAV, the better it is. Performance is based on the growth of NAV during the referral period after taking into consideration Dividend paid.

Growth = $(NAV_1 – NAV_0) + D_1 / NAV_0$.

(2) **Timing** – The timing when the mutual fund is raising money from the market is vital. In a bullish market, investment in mutual fund falls significantly in value whereas in a bearish market, it is the other way round where it registers growth. The turns in the market need to be observed.

(3) **Size of Fund** – Managing a small sized fund and managing a large sized fund is not the same as it is not dependent on the product of numbers. Purchase through large sized fund may by itself push prices up while sale may push prices down, as large funds get squeezed both ways. So it is better to remain with medium sized funds.

(4) **Age of Fund** – Longevity of the fund in business needs to be determined and its performance in rising, falling and steady markets have to be checked. Pedigree does not always matter as also success strategies in foreign markets.

(5) **Largest Holding** – It is important to note where the largest holdings in mutual fund have been invested.

(6) **Fund Manager** – One should have an idea of the person handling the fund management. A person of repute gives confidence to the investors.

(7) **Expense Ratio** – SEBI has laid down the upper ceiling for Expense Ratio. A lower Expense Ratio will give a higher return which is better for an investor.

(8) **PE Ratio** – The ratio indicates the weighted average PE Ratio of the stocks that constitute the fund portfolio with weights being given to the market value of holdings. It helps to identify the risk levels in which the mutual fund operates.

(9) **Portfolio Turnover** – The fund manager decides as to when he should enter or quit the market. A very low portfolio turnover indicates that he is neither entering nor quitting the market very frequently. A high ratio, on the other hand, may suggest that too frequent moves have lead the fund manager to miss out on the next big wave of investments. A simple average of the portfolio turnover ratio of peer group updated by mutual fund tracking agencies may serve as a benchmark. The ratio is lower of annual purchase plus annual sale to average value of the portfolio.

8. SIGNALS HIGHLIGHTING THE EXIT OF THE INVESTOR FROM THE MUTUAL FUND SCHEME

(1) When the mutual fund consistently under performs the broad based index, it is high time that it should get out of the scheme. It would be better to invest in the index itself either by investing in the constituents of the index or by buying into an index fund.

(2) When the mutual fund consistently under performs its peer group instead of it being at the top. In such a case, it would have to pay to get out of the scheme and then invest in the winning schemes.

(3) When the mutual fund changes its objectives e.g. instead of providing a regular income to the investor, the composition of the portfolio has changed to a growth fund mode which is not in tune with the investor's risk preferences.

(4) When the investor changes his objective of investing in a mutual fund which no longer is beneficial to him.

(5) When the fund manager, handling the mutual fund schemes, has been replaced by a new entrant whose image is not known.

9. MONEY MARKET MUTUAL FUNDS (MMMFS)

The Government of India thought of introducing Money Market Mutual Funds (MMMFs) on Indian financial canvass in 1992. The aim of the Government was to develop the money market and to enable individual investors to gain from money market instruments since it is practically impossible for individuals to invest in instruments like Commercial Papers (CPs), Certificate of deposits (CDs) and Treasury bills (TBs) which require huge investments. The Government constituted a Task Force on MMMFs under the chairmanship of Shri D. Basu.

The broad framework of guidelines in respect of MMMFs issued by RBI are as follows:

❖ The investment by individuals and other bodies would be in the form of negotiable and transferable instruments and MMMF deposit accounts.

❖ The minimum investments would be ₹ one lakh.

❖ The re-purchase would be subject to a minimum lock-in-period of 3 months.

❖ The funds will not be subject to reserve requirements as these will be invested in money market instruments.

- ❖ Minimum of 20 per cent of funds will be invested in 182 days treasury bills.
- ❖ Maximum of 20 per cent of funds will be diverted to call money markets.

Money market funds are generally the safest and most secure of mutual fund investments. The goal of a money-market fund is to preserve principal while yielding a modest return. Money-market mutual fund is akin to a high-yield bank account but is not entirely risk free. When investing in a money-market fund, attention should be paid to the interest rate that is being offered.

10. EXCHANGE TRADED FUNDS (ETFS)

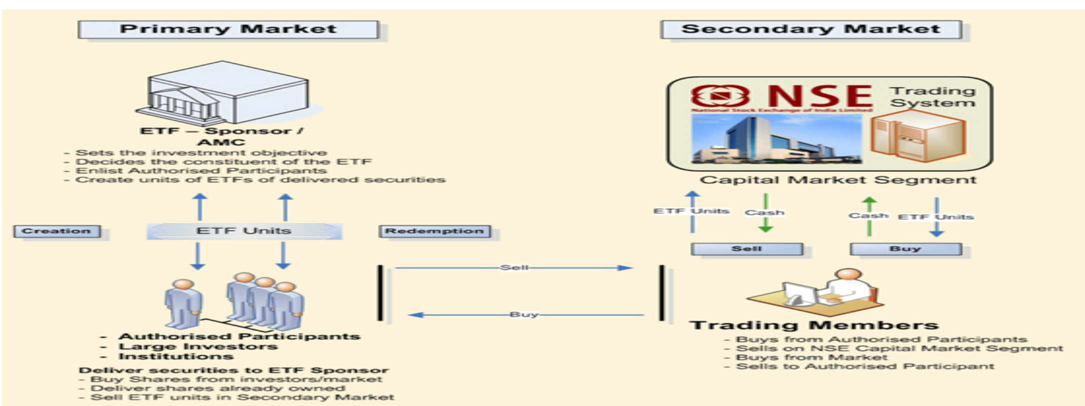
10.1 Introduction

An exchange-traded fund (ETF) is a Mutual Fund Scheme that is traded on stock exchanges, much like stocks. If the ETF represents a portfolio, it being listed as an ETF means the entire portfolio is being traded as one unit at the Stock Exchange. ETFs can be diverse; the portfolio may comprise stocks, bonds, commodities, index, etc. It usually trades close to its intrinsic value or market value of the underlying assets, but it is nothing hard and fast.

10.2 Advantages of ETFs

Fund management expenses are low in ETFs than actively managed funds, as these are passively managed funds, investing in assets like gold or equity index.

- ETFs offer intra-day purchase and sale on the Exchange, which suits active traders. This is not possible in conventional funds.
- Close-ended funds have a fixed corpus. ETFs also have a given corpus, but that may change as per demand. Authorized Participants can create new units or redeem existing units with the AMC. This makes the ETF price realistic i.e. it moves with the movement in the underlying market.



Equity ETFs listed on NSE

Issuer Name	Name	Underlying	Launch Date
Edelweiss AMC	Edelweiss Exchange Traded Scheme - NIFTY	NIFTY 50 Index	08-May-2015
ICICI Prudential AMC	ICICI Prudential NIFTY ETF	NIFTY 50 Index	20-Mar-2013
Kotak AMC	Kotak NIFTY ETF	NIFTY 50 Index	02-Feb-2010
Motilal Oswal AMC	MOSt Shares M50	NIFTY 50 Index	28-Jul-2010
Quantum AMC	Quantum Index Fund - Growth	NIFTY 50 Index	10-Jul-2008
Religare AMC	Religare Invesco NIFTY ETF	NIFTY 50 Index	13-Jun-2011
SBI AMC	SBI ETF NIFTY	NIFTY 50 Index	23-Jul-2015
UTI AMC	UTI NIFTY ETF	NIFTY 50 Index	03-Sep-2015
Birla Sun Life AMC	Birla Sun Life NIFTY ETF	NIFTY 50 Index	21-Jul-2011
ICICI Prudential AMC	ICICI Prudential CNX 100 ETF	NIFTY 100	20-Aug-2013
Kotak AMC	Kotak Banking ETF	NIFTY Bank	04-Dec-2014
SBI AMC	SBI ETF Banking	NIFTY Bank	20-Mar-2015
Motilal Oswal AMC	MOSt Shares M100	NIFTY Midcap 100	31-Jan-2011
SBI AMC	SBI ETF NIFTY Junior	NIFTY Next 50	20-Mar-2015
Kotak AMC	Kotak PSU Bank ETF	NIFTY PSU BANK	08-Nov-2007
ICICI Prudential AMC	ICICI Prudential Sensex ETF	S&P BSE Sensex	10-Jan-2003
UTI AMC	UTI Sensex ETF	S&P BSE Sensex	03-Sep-2015
Reliance Nippon Life Asset Management Limited	Reliance ETF NIFTY BeES	NIFTY 50 Index	28-Dec-2001
	Reliance ETF NIFTY 100	NIFTY 100	22-Mar-2013
	Reliance ETF Bank BeES	NIFTY Bank	27-May-04
	CPSE ETF	NIFTY CPSE Index	28-Mar-14

	Reliance ETF Dividend Opportunities	NIFTY Dividend Opportunities 50	15-Apr-14
	Reliance ETF Consumption	NIFTY India Consumption	03-Apr-14
	Reliance ETF Infra BeES	NIFTY Infrastructure	29-Sep-10
	Reliance ETF Junior BeES	NIFTY Next 50	21-Feb-03
	Reliance ETF PSU Bank BeES	NIFTY PSU BANK	25-Oct-07
ICICI Prudential AMC	BHARAT 22 ETF	S&P BSE BHARAT 22 index	28-Nov-17

11. REAL ESTATE INVESTMENT TRUSTS (REITs)

11.1 Introduction

A Real Estate Investment Trust (ReIT) is a form of investing in real estate, where the operator, the REIT, owns, and operates the real estate. ReITs may own commercial real estate like warehouses, offices, etc. ReITs can be publicly traded or private. The unit-holders of a REIT earn their income from real estate without directly owning it. As a regulation, REITs must pay out at least 90% of their income to unit-holders.

Type of ReIT	Holdings
Equity	Own and operate income-producing real estate
Mortgage	Provide mortgages on real property
Hybrid	Own properties and make mortgages

11.2 Indian Context

SEBI notified regulations for investment trusts in September 26, 2014: specifically, real estate investment trusts (REITs) and infrastructure investment trusts (InvITs) – which was subsequently amended in September 23, 2016. REITs and InvITs allow sponsors to monetize revenue-generating real estate and infrastructure assets while enabling investors or unit holders to invest in these assets without actually owning them. REITs and InvITs enjoy favourable tax treatment, including exemption from dividend distribution tax and relaxation of capital gains tax.

11.3 Structure of investment trust

Investment trusts to hold assets either directly or through SPV. Investment trusts can invest in two-level SPV structure through Holding Company (Holdco), subject to sufficient shareholding in the Holdco and the underlying SPV and other safeguards including the following:

a. Investment trusts to have right to appoint majority directors in the SPV(s),

b. Holdco to distribute 100% cash flows realized from underlying SPVs and at least 90% of the remaining cash flows.

Mandatory sponsor holding of not less than 25% of the total units of the REIT after initial offer on a post-issue basis (the minimum sponsor holding specified in this clause shall be held for a period of at least three years from the date of listing of such units). The sponsor shall together hold not less than 15% of the outstanding units of the listed REIT at all time. In the case of InvIT, mandatory sponsor holding is 15%. There is no limit on the number of sponsors both in the case of REIT and InvIT. REITs can invest up to 20% in under-construction assets, while InvITs (through public issue) can invest up to 10% in under-construction assets.

Investment trusts to hold controlling interest and not less than 50% equity share capital or interest in the SPVs (except in the case of public private partnership projects where such holding is disallowed by the government or regulatory provisions).

SPVs to hold not less than 80% of assets (90% in case of InvITs) directly in properties (infrastructure projects for InvITs) and not invest in other SPVs.

SPVs to not engage in any activity other than those pertaining and incidental to the underlying projects.

11.4 Stipulations to ensure transparency

Trustee to hold assets for the benefit of unit holders, oversee activities, and ensure compliance with respect to reporting and disclosure requirements.

A full valuation shall be conducted by an independent valuer not less than once in every financial year; a half yearly valuation of the assets shall be conducted by the valuer for the half-year ending September 30 for incorporating any key changes in the previous six months.

All related-party transactions to be on an arm's-length basis.

11.4.1 Distribution requirements

Not less than 90% of net distributable cash flow of the SPV to be disbursed to the investment trust in proportion to its holding in the SPV subject to applicable provisions in the Companies Act, 2013, or the Limited Liability Partnership Act, 2008.

Not less than 90% of net distributable cash flow of the investment trust to be distributed to unit holders.

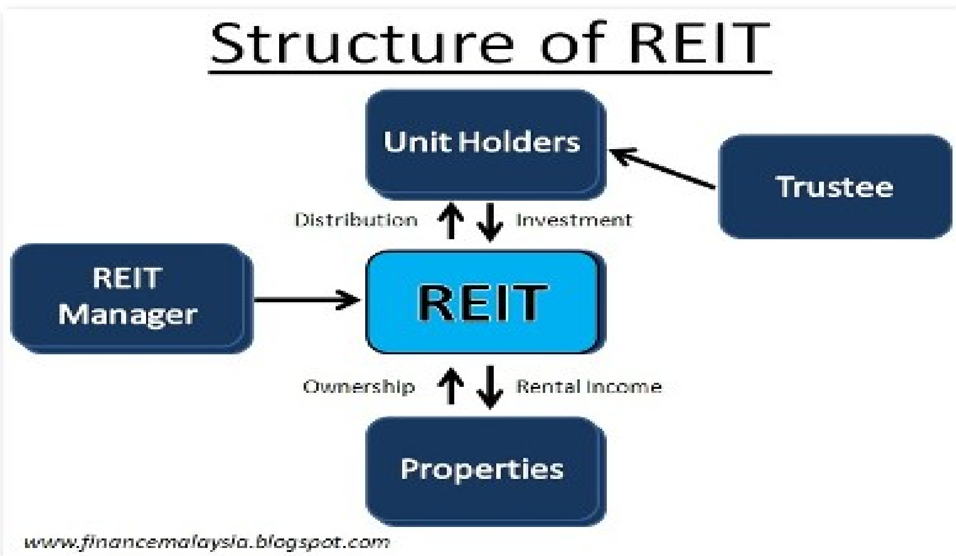
11.4.2 Leverage restrictions

The aggregate consolidated borrowing and deferred payment of the investment trust net of cash and cash equivalents should never exceed 49% of the value of the investment trust assets.

If the aggregate consolidated borrowing and deferred payment of the investment trust, net of cash and cash equivalents, exceeds 25% of the value of the assets, for any further borrowing, credit rating to be obtained from a registered credit rating agency.

An investment trust is a vehicle created to primarily invest in revenue-generating real estate or infrastructure assets. These entities are 'trusts' by definition, and their 'units' (shares), after the initial offer, are to be listed on exchanges and regulated by the Securities and Exchange Board of India (SEBI). The units are traded based on their net asset value. These entities have a pass-through structure and are therefore required to distribute majority of their earnings to unit holders. As per SEBI's regulatory requirement, if the aggregate consolidated borrowing and deferred payment of the investment trust, net of cash and cash equivalents, exceeds 25% of the value of the assets, for any further borrowing, credit rating has to be obtained from a registered credit rating agency.

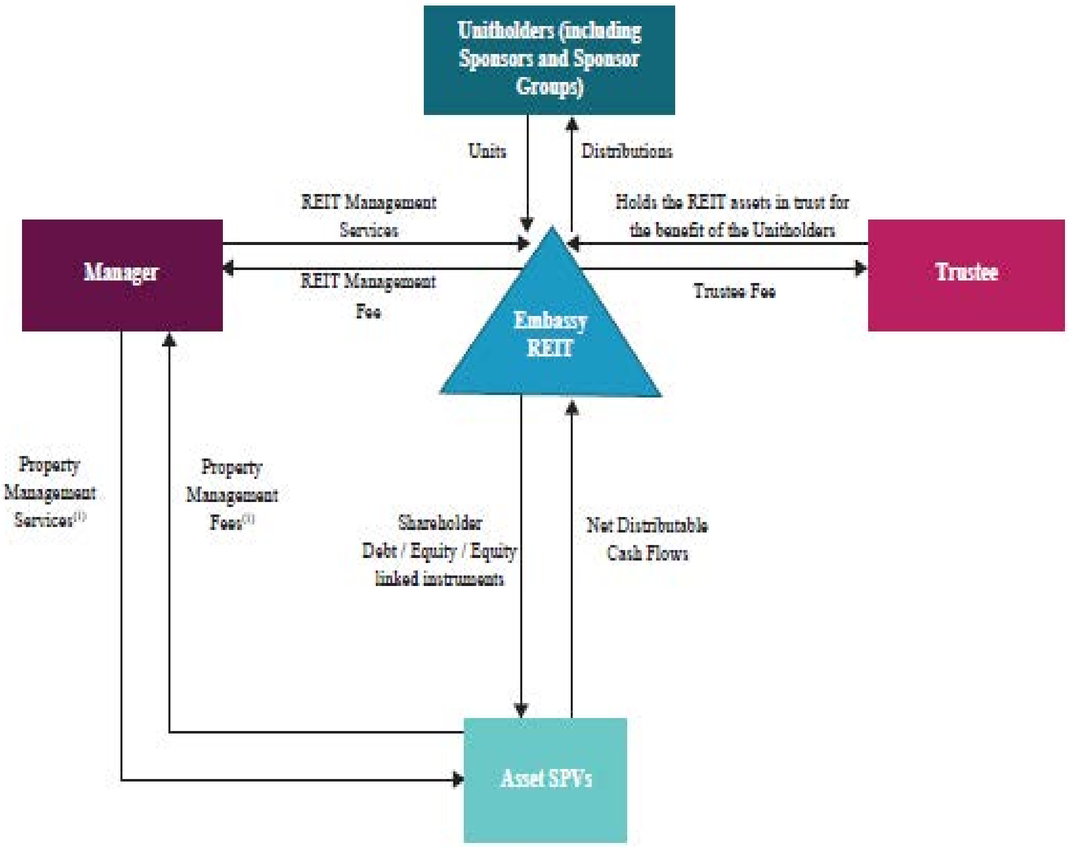
Given regulatory oversight of these entities, investment trusts have a number of aspects that lend a relatively positive bias to the creditors compared to direct credit to real estate and infrastructure assets. These aspects include limits on under-construction assets, cap on aggregate gearing levels, mandatory listing, ensuring minimum sponsor holding in the investment trust, ensuring minimum controlling stake in the Special Purpose Vehicle (SPV), independent valuation of the assets, trustee monitored transparency, compliance and disclosure requirements. Investment trusts also have flexibility in holding the assets either directly or through an SPV or an intermediate holding company.



Source: Google to https://commercialobserver.com/2013/03/reit-so-sweet-investors-reconsider-real-estate-investment-trusts/

ReITs are yet to take off in India; the first IPO of REIT has just been announced. Embassy Office Parks REIT, backed by Blackstone Group, plans to raise about ₹ 4,750 crore ($682 million) in India's first real estate investment trust listing. The REIT, which includes Embassy Group properties, will offer 158.6 million units at ₹ 299 to ₹ 300 apiece. It will start taking orders from anchor investors before moving on to a public offering March 18 through March 20. A successful listing of the REIT, expected by April 3 according to the terms, will potentially open a fundraising avenue for India's cash-starved property companies. The nation's real estate developers are struggling with sluggish sales and price declines. The trust's portfolio comprises about 33 million square feet of office space across four Indian cities, Bengaluru, Pune, Mumbai and Noida, as per Offer Document filed with SEBI. Its Express Towers property, located in Mumbai's central business district, counts Wells Fargo & Co., Warburg Pincus as well as Blackstone as tenants.

The following chart illustrates the relationship between the Embassy REIT, the Trustee, the Manager and the Unitholders (which include the Sponsors) on the Listing Date.



Source: Embassy REIT Offer Document

12. INFRASTRUCTURE INVESTMENT TRUSTS (INVITs)

An InvITs is a pool of money for investing in infrastructure projects and distribution of the earnings to the unit holders. An InvIT issues units that are listed at the Stock Exchange. In that sense, InvITs are like Exchange Traded Funds (ETFs) of Mutual Funds. The difference is, in a Mutual Fund, the underlying portfolio of shares or bonds change in value every day and there is an NAV declared every day. An InvIT invests in the projects which are identified as Special Purpose Vehicles (SPVs) that are not valued everyday but once in six months for publicly offered InvITs. Both InvITs and Mutual Funds are regulated by SEBI.

InvITs are set up as a trust and registered with SEBI. An InvIT involves four entities: Trustee, Sponsor, Investment Manager and Project Manager. The trustee, who oversees the role of an InvIT, is a SEBI registered debenture trustee and he cannot be an associate of the Sponsor or Manager. 'Sponsor' means promoters and refers to any company or body corporate with a net worth of ₹ 100 crore which sets up the InvIT and is designated as such while applying to SEBI. Promoters or Sponsor, collectively, have to hold at least 25% in the InvIT for minimum 3 years. Value of the assets owned/proposed to be owned by InvIT shall be at least ₹ 500 crore. Minimum issue size for initial offer is ₹ 250 crore. InvITs are allowed to add projects in the same vehicle in future so that investors can benefit from diversification as well as growth in their portfolio.

Given the challenging phase of infrastructure in the country today, InvITs may provide an alternate source of funds. Several existing infrastructure projects which are under development in India are delayed and 'stressed' on account of varied reasons like increasing debt finance costs, lack of international finance flowing to Indian infrastructure projects, project implementation delays caused by various factors like global economic slowdown, cost overruns, etc. InvITs may offer a source of long-term re-finance for existing infrastructure projects. InvITs may help in attracting international finance into Indian infrastructure sector. These would also enable the investors to hold a diversified portfolio of infrastructure assets.

Among Asian markets, Singapore is a success story for listed Trusts. In Singapore, there are 39 listings with a market capitalization of approx $70 billion, but the bias is on REITs than on InvITs. Over a period of time, India may go the Singapore way, but the initial experience of investors from REITs and/or InvITs, from the one InvIT getting listed and others in the pipeline, should be sanguine.

There is a debate on whether an InvIT, by nature of investment, is equity or debt as it has features of both. It is somewhere in between; loosely, debt-plus or equity-minus in terms of risk return profile. The equity-like features are that the units are listed, can change hands like equity stocks, there is periodic valuation of the projects akin to periodic results of companies and economic factors like higher GDP growth or higher inflation would lead to expectation of higher revenue and hence higher price of the units at the Exchange. The debt-like feature is that are that there is periodic pay-out of the earnings of the InvIT from the underlying SPVs, which is not exactly like contractual coupon pay-out on bonds but somewhat comparable as the valuation gives a perspective on how much to expect. It is a hybrid instrument with a somewhat predictable cash flow yield (akin to debt) and potential appreciation with growth of the economy (akin to equity).

Taxation wise, an InvITs is a pass-through vehicle. There is a mandate to distribute at least 90% of net-distributable cash flows. Interest component of income distributed by trust to the unit holders would attract withholding tax @ 10% for resident unit holders. Interest income is taxable in the hands of the unit holder. Dividend income is exempt in the hands of the unit holder and there is no dividend distribution tax.

At this point of time, InvIT is not a retail product, the minimum primary application amount being ₹10 lakh and the minimum secondary transaction amount being ₹ 5 lakh. The restriction is imposed because there is no track record and lack of awareness. There is a liquidity risk as well, in the secondary market the units may not be traded every day as the investor base is not wide at this point of time. May be over a period of time, with the development of this market, SEBI would look to easing the threshold amount for REITs and InvITs. As of now, investors should keep it on the radar and participate through the mutual fund route who have a better understanding of the risk factors and can handle secondary market liquidity issues.

The first two listed InvITs are currently trading below their issue price. As on October 2017, the price of the two listed InvITs was as follows:

Issuer	Issue price (Rs)	High (Rs)	Low (Rs)	Current (Rs)	Yield at the time of initial issue (%)	Current yield (%)
India Grid Trust	100	100	90.5	95.5	10.9	11.4
IRB InvIT Fund	102	105	92.76	94.5	12	13.0

13. CASE STUDY: IL&FS DEFAULT AND HANDLING BY MUTUAL FUNDS

13.1 IL&FS: chronology of events

While the Group was under cash flow issues for some time, the first noticeable incident was a default by a group company called IL&FS Transportation Networks Limited (ITNL). This led to a one notch downgrade of the flagship company, IL&FS, on 6 August 2018. For the first time, IL&FS lost the AAA status.

Infrastructure Leasing & Financial Services Limited

August 06, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial paper programme	2,500.00	2,500.00	[ICRA]A1+&; reaffirmed and placed under Watch with Developing Implications
Long Term – Term Loans	350.00	350.00	[ICRA]AA+&; downgraded from [ICRA]AAA(stable) and placed under Watch with Developing Implications
Non-Convertible Debenture Programme	4,475.00	4,475.00	[ICRA]AA+&; downgraded from [ICRA]AAA(stable) and placed under Watch with Developing Implications
Total	**7,325.00**	**7,325.00**	

& - Under rating watch with developing implications; *Instrument details are provided in Annexure-1;

Over the month of October, issues in the Group started surfacing and the market started selling off IL&FS debt papers i.e. in the secondary market, yields were moving up and prices were coming down. There was speculation whether they would default or they would be able to manage the situation. Things came to a halt in September 2018.

Infrastructure Leasing & Financial Services Limited

September 08, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture Programme	5,225.00	5,225.00	[ICRA]BB&; downgraded from [ICRA]AA+& and remain under watch with developing implications
Commercial paper programme	2,500.00	2,500.00	[ICRA]A4&; downgraded from [ICRA]A1+& and remain under watch with developing implications
Long Term – Term Loans	350.00	350.00	[ICRA]BB&; downgraded from [ICRA]AA+& and remain under watch with developing implications
Total	**8,075.00**	**8,075.00**	

On 8 September 2018, it was downgraded to junk. The debentures were downgraded to BB from AA+ and Commercial Papers were dumped to as low as A4. On 17 September 2018, it was downgraded straight to default grade.

Infrastructure Leasing & Financial Services Limited

September 17, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture Programme	5,225.00	5,225.00	[ICRA]D; downgraded from [ICRA]BB& and removed from watch with developing implications
Commercial paper programme	2,500.00	2,500.00	[ICRA]D; downgraded from [ICRA]A4& and removed from watch with developing implications
Long Term – Term Loans	350.00	350.00	[ICRA]D; downgraded from [ICRA]BB& and removed from watch with developing implications
Total	**8,075.00**	**8,075.00**	

Now the question is, how the Mutual Funds would treat the bonds for valuation purposes. As per SEBI rules, AMCs have as much as 18 month to write off. The SEBI rule on write off is as follows:

"The value of the asset shall be provided in the following manner or earlier at the discretion of the Mutual Fund. Mutual Funds will not have discretion to extend the period of provisioning. The provisioning against the principal amount or instalments shall be made at the following rates irrespective of whether the principal is due for repayment or not.

a. 10 percent of the book value of the asset shall be provided for after 6 months past due date of interest i.e. 3 months form the date of classification of the asset as NPA.

b. 20 percent of the book value of the asset should be provided for after 9 months past due date of interest i.e. 6 months from the date of classification of the asset as NPA.

c. Another 20 percent of the book value of the assets shall be provided for after 12 months past due date of interest i.e. 9 months from the date of classification of the asset as NPA.

d. Another 25 percent of the book value of the assets shall be provided for after 15 months past due date of interest i.e. 12 months from the date of classification of the asset as NPA.

The balance 25 percent of the book value of the asset shall be provided for after 18 months past due date of the interest i.e. 15 months from the date of classification of the assets as NPA."

That is, AMCs have the leeway to write-off over the period of 18 months. However, there was a meeting of the valuation committee of AMFI and though it is not legally binding on AMCs, they took an initial hit of 25% of the holding amount. Within a short span of time, AMCs wrote off the entire holding i.e. did 100% write off. The loss was passed on to investors.

Another fallout of the write-off was that the units were available at a discount so to say, in the sense if IL&FS pays back something at a later date after the 100% write-off, it will be like a bonus.

Moreover, as a rule, AMCs cannot stop redemptions, which may be one of the options to prevent a run on the fund due to an exposure turning bad. However, purchases can be stopped as it is a business decision. The initial reaction of AMCs was to stop purchases after the 100% write-off. Here is one example:

Union Mutual Fund (formerly Union KBC Mutual Fund)
Union Asset Management Company Private Limited
(formerly Union KBC Asset Management Company Private Limited)
Investment Manager for Union Mutual Fund
Corporate Identity Number (CIN): U65923MH2009PTC198201
Registered Office: Unit 503, 5th Floor, Leela Business Park, Andheri Kurla Road, Andheri (East), Mumbai - 400059
• Toll Free No. 18002002268; • Non Toll Free. 022-67483333; • Fax No: 022-67483401;
• Website: www.unionmf.com; • Email: investorcare@unionmf.com

Union MUTUAL FUND
Your Bridge to Responsible Investing

NOTICE CUM ADDENDUM TO THE SCHEME INFORMATION DOCUMENT (SID) AND KEY INFORMATION MEMORANDUM (KIM) OF UNION LIQUID FUND

NOTICE is hereby given that the Board of Directors of Union Trustee Company Private Limited (**"the Trustee Company"**) and the Board of Directors of Union Asset Management Company Private Limited (**"the AMC"**) have temporarily suspended all subscriptions / switch-in application(s) and other pre-registered investments in Union Liquid Fund, an Open-ended Liquid Scheme, through any mode including the stock exchange platform, with **immediate effect** to protect the interest of unit holders.

The aforementioned suspension will continue till further notice.

Any redemptions including switch-out, Systematic Transfer Plan (STP) or Systematic Withdrawal Plan (SWP) registered under Union Liquid Fund would continue (without any change) as per the terms of the SID and KIM of Union Liquid Fund.

The SID and KIM of Union Liquid Fund will stand modified to the extent mentioned above.

This Addendum forms an integral part of the SID and KIM of Union Liquid Fund. All other terms and conditions of Union Liquid Fund remain unchanged.

For Union Asset Management Company Private Limited
(Investment Manager for Union Mutual Fund)

Place: Mumbai | Sd/-
Date: September 19, 2018 | **Authorised Signatory**

Union Liquid Fund wrote off the exposure to IL&FS in their Liquid Fund and stopped purchases on 19 September 2018, as in a way the units of Liquid Fund were available at a discount, assuming IL&FS will pay back something in future.

Since business was being impacted, they opened up after sometime. In spite of opening up and the apparent discount on NAV of units, they did not receive much of inflows. Sentiments on the Fund were impacted as well, and corporate investors are particular about the corpus size of the Fund they invest in. After sentiments getting impacted, corporate investors were wary of the size of the Fund going forward.

Like Union, there were multiple other AMCs who wrote off their exposure to IL&FS, closed their Fund for subscriptions, and opened up gradually.

13.2 What was the issue with IL&FS?

Funding long term projects with short term funding sources.

Infrastructure sector cash flows are slow. Anything getting stuck means debt servicing getting impacted.

Maze of 348 subsidiaries. Risk committee, which included the LIC Chairman, had not met for a long time.

Serious Fraud Investigation Office (SFIO) and Enforcement Directorate (ED) are involved, in case there was some other fraud / wrong-doing.

The AAA credit rating was based on the nature of ownership i.e. shareholding of the company, assuming support from parents in case of any issue. This is popularly known as 'name-rating', something similar to 'name-lending'. Shareholding pattern of IL&FS is as follows:

No	Name of Shareholder	Number	%
1	Life Insurance Corporation of India	32,541,123	25.34
2	ORIX Corporation, Japan	30,227,509	23.54
3	Abu Dhabi Investment Authority	16,129,252	12.56
4	IL&FS Employees Welfare Trust	15,407,658	12.00
5	Housing Development Finance Corporation Ltd	11,587,194	9.02
6	Central Bank of India	9,843,386	7.67
7	State Bank of India	8,237,967	6.42
8	UTI - Unit Linked Insurance Plan	1,051,111	0.82
9	India Discovery Fund	1,104,211	0.86
10	Others	2,273,865	1.77
	Total	128,403,276	100.00

13.3 Judgement by NCLAT

For proceeding ahead with the resolution of the beleaguered Group and settlement of debts, the new management of the Group proposed segregation of the companies into three categories:

Green: those in a position to pay all creditors

Amber: those in a position to pay only operational creditors

Red: doubtful.

This was accepted by the NCLAT.

As per an announcement by the IL&FS Group on 3 April 2019, the situation stands as under:

Domestic entities: Green, Amber, Red categorisation

IL&FS

- Categorization based on **cash-flow solvency test** was carried out **to determine course of action** i.e. managing liquidity, implementing payment protocol etc. until resolution is implemented
- **157 (out of 169) Domestic IL&FS entities** have been categorized in 3 categories viz. **"Green"**, **"Amber"** & **"Red"**

Summary – Entity categorization based on 12 month cash flow solvency test

Category	# of Entities	# of Entities with External Debt	External FB Debt (INR Cr)
Green	54	19	10,472 (12%)
Amber	13	13	16,372 (18%)
Red	82	33	61,375 (69%)
Under Liquidation /CIRP/ Striking Off	8	1	6 (0.007%)
Entities Categorized (A)	**157**	**66**	**88,225 (99%)**

The Mutual Fund Schemes with exposure to Red entities and to an extent even Amber entities, stand to lose a part of the investments, as only a part of the money may be recovered.

13.4 Learnings from the IL&FS case

Mutual Funds are investment vehicles. In equity-oriented funds, NAV moves along with the movements in the underlying market. This is true for debt-oriented funds also, but the debt market is relatively less volatile. Any loss / default in a fixed income instrument will be passed on to investors.

Mutual Funds cannot stop redemptions, but can stop purchases and can open up for purchases, as an in-house decision, without any SEBI intervention.

For writing off any loss, though AMCs have 18 months, they can do it earlier also.

A mark-to-market loss due to market movement e.g. volatile movement in equity market can be recovered from positive market movement in future. A loss due to bond default can be recovered through the legal process, partially.

Credit risk is part of the risk of investing in debt funds.

14. CASE STUDY: LOAN AGAINST SECURITIES EXPOSURE TO ESSEL GROUP ENTITIES OF MUTUAL FUNDS

Among other instruments, debt mutual funds invest in what is popularly known as 'promoter funding' i.e. loan given to promoters of a company, against pledge of shares of the company / Group entity. Since a Mutual Fund Scheme cannot give a one-to-one loan, it is done in the form of a bond / debenture of one of the entities of the Group. This bond, as against being formally secured by charge against the assets of the company, is secured by pledge of shares.

Recently, Essel Group entities are in cash flow trouble and when the share cover dipped below the agreed level, they could not top-up with more shares or pay up part of the loan. The MF industry have agreed to a moratorium period upto 30 September 2019, that they will not sell pledged equity shares of Zee Group entities, even if share cover dips below the contracted level. This is done to prevent a run on the shares of the company, which would lead to dip in share price and dip below contracted level of security for all holders of the Loans-against-Shares (LAS) of Essel Group.

In an open ended MF Scheme, it is possible to handle the problem as only part of the fund would be redeemed on a given day or given period. When some Fixed Maturity Plans (FMPs) came up for maturity, one large AMC is seeking to extend the FMP for one more year. Another AMC is maturing the good part of the FMPs on due date and the balance will be matured on 30 September 2019.

Learning Outcome

Bonds are of two types, secured and unsecured. Secured means the bonds are secured by charge against assets of the company, which could be land or building or machinery or receivables. If a company defaults, the security i.e. the charged assets can be sold off and the money realized. However, if a company defaults, or is not in good shape, the bank would rather not realize the assets but 'evergreen' the loan. Even if the lender intends to sell the charged assets, it is not the bank's discretion but it has to go through the court of law. Once a case goes to the court of law, how much time it takes to settle, years or decades, is anybody's guess. The first ray of light came in the form of The Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (also known as the SARFAESI Act). We were told, by the provisions of the Act, that it allows banks and other financial institution to auction residential or commercial properties (of the defaulter) to recover loans.

In the Loan-Against-Securities (LAS) deals discussed above, the promoters did not put up additional collateral shares / pay up cash when the equity shares price crashed and coverage dipped below the stipulated minimum. To be noted, in case of default, shares can be sold by the lender, without the intervention of the court of law as in case of 'secured' bonds with charge against physical assets. These LAS deals, post non-top-up, are being given a shady description and there is a perception that bonds secured by equity shares are effectively unsecured. Let's pause a moment and think, what's the security in a 'secured bond'? The charge against physical assets is typically 1 to 1.25 times of the value of the bond, though it may be a higher coverage. The audit on whether it is being maintained at the stipulated coverage is done once a year and there too I am not sure whether it is monitored religiously. The point is, the security coverage or lack of it is not as optically visible and we tend to believe it is secured. Basically, it is lack of information. In a LAS deal, if the stipulated coverage is 2 times, there is a share price discovery every day and the extent of security coverage can be monitored by the lender every day.

It is not so much about the security collateral. It is about whether the borrowing corporate pays the interest on due dates and principal on maturity. That in turn depends on whether the corporate has the money to pay and the intention to pay. Ownership stocks are closer to the heart of the promoter and bind them better than losing some physical assets.

CHAPTER 10

PRIVATE EQUITY

LEARNING OUTCOMES

After going through the chapter student shall be able to understand

- Meaning and Classification
  - (1) Venture Capital
  - (2) Buyouts
  - (3) Hurdle Rate
  - (4) Paid in Capital
  - (5) Term Sheet
- Cost of Investing in Private Equity
- Exit Routes
- Valuation of Private Equity Transactions
- Private Equity Funds (Distribution of returns in General Partner and Limited Partners)

1. MEANING OF PRIVATE EQUITY (PE)

Private equity is the capital brought in by the Private Equity firms (simply called as 'PE firms') into the enterprise as part of equity capital. PE firms are the investment fund companies who take strategic stake in the enterprise once the enterprise is established as a successful cash generating unit. This is the basic difference – the PE would come in post the Venture Capitalist (VC) - a typical example will be of a PE firm replacing a VC interested to exit out by repaying off its investment debt, and taking a position in the equity capital of the firm. PE firms are in a broader sense, the long term investors into the enterprise and act like 'mentors' to the management.

Industry Overview

Private Equity (PE) is the alternate form of investment, as compared to publicly traded equity markets, where the PE investor (or the PE firm) invests majorly into startups and emerging sectors through strategies like early funding, venture capital, growth capital, etc. The main characteristic is that these investments function on a higher risk to reward model, and in order to amplify the returns, the PE firms use a leveraged approach of using debt as the funding instrument. PE firms target a return based on IRR or the 'multiple based' approach.

The PE industry has grown significantly in the past three decades, and over a period of time PE firms like Bain Capital, Blackstone have grown tremendously entering successfully into Asian markets too. There was a temporary setback in the PE industry during the dotcom bubble seen in 2000-2003, but has staged a comeback, stronger and more resilient. The growth in PE has also seen marked increase in regulations in both US and Europe. In US, the SEC regulates PE industry, and in addition has added FATCA (Foreign Account Tax Compliance Act) and the Alternative Investment Fund Managers Directive to have greater transparency in the workings of PE.

The below table gives us an insight into the largest Private Equity-Backed Buyout Deals in 2016:

Portfolio Company	Investment Type	Deal Date	Deal Size (mn)	Deal Status	Investor(s)	Bought from/ Exiting Company	Location	Industry
ADT Security Services, Inc.	Merger	Feb-16	15,000 USD	Completed	Apollo Global Management, Koch Equity Development LLC, Protection 1 / ASG Security**	-	US	Electronics
Supercell Oy	Buyout	Jun-16	8,600 USD	Announced	AVIC Capital, CITIC Capital, Pagoda Investment, Shanghai Pudong Development Bank, Sino-Rock Investment Management, Tencent**, Zheng Hong Capital	Softbank Capital	Finland	Gaming
MultiPlan, Inc.	Buyout	May-16	7,500 USD	Completed	GIC, Hellman & Friedman, Leonard Green & Partners	Ardian, Partners Group, Starr Investment Holdings	US	Healthcare IT
Team Health Holdings, Inc	Public-to-Private	Oct-16	6,100 USD	Announced	Blackstone Group	-	US	Healthcare
Cabela's Inc	Add-on	Oct-16	5,500 USD	Announced	Bass Pro Shops**, Goldman Sachs Merchant Banking Division, Pamplona Capital Management	-	US	Retail
Playtika Ltd	Buyout	Jul-16	4,400 USD	Announced	CDH Investments, China Minsheng Trust, China Oceanwide Holdings Group, Giant Interactive Group, Hony Capital, YF Capital	Caesars Entertainment Corporation	Israel	Gaming
Rackspace Hosting, Inc.	Public-to-Private	Aug-16	4,300 USD	Completed	Apollo Global Management**, Searchlight Capital Partners	-	US	IT
Ultimate Fighting Championship Ltd	Buyout	Jul-16	4,000 USD	Announced	KKR, MSD Capital, Silver Lake, William Morris Endeavor Entertainment, LLC**	-	US	Media

Source: *Preqin Private Equity Online*

The concept of alternate investments has slowly gained a steady trajectory in India. An excerpt from *The Economic Times* dated Mar 11, 2017 on the PE industry in India - 'The year 2016 turned out to be a mixed bag for India in term of private equity and venture capital investments. The volume and value of these investments in 2016 decreased by 25% and 39% respectively compared to the year before (2015). This decline was expected as the flurry of investments in 2015 was shouldered by a high volume of startup deals during the year. In 2016, the political and economic turmoil in Europe, including Brexit, rising oil prices and increased risk premium for technology/internet sector investments affected the sentiments of foreign investors.

2. CLASSIFICATION OF PRIVATE EQUITY

2.1 Venture Capital (VC)

2.1.1 Introduction

Fertile brains can generate ideas – Venture capitalists provide the money to fuel these ideas and innovations to reality. Simply put 'venture capital' is the capital provided to especially new startups and entrepreneurship enterprises to stand up and deliver.

A venture capitalist is the institutional investor who has the access to liquid funds and is ever willing to part it with talented startups and innovative enterprises that require that extra bit of hand holding. Note the word used 'ever willing' will essentially be the distilled result of a strict selection criteria based evaluation of the startup, its promoters, its vision and of course, the numbers in terms of estimated cash flows, breakeven point, and a whole lot of similar parameters that we would see shortly.

Some of the most successful ideas in the new age world have got the momentum and the trajectory all but thanks to venture funds – WhatsApp, Spotify, Facebook – all had venture capitalists helping them to get the much required capital as well as to get them to get on to the big stage of mergers and takeovers by larger entities.

A venture capital fund, as opposed to a venture capitalist, is a firm that works as an investment fund having pooled resources from various self styled and serious venture capitalists, and is seeking private equity stake in startups and innovative enterprises.

VCs usually invest as either 'early stage' funds or 'late stage' funds. Early stage would mean the VC is taking a more riskier approach of investing in startups exhibiting 'raw potential', whereas later stage would mean the less riskier way of investing in firms having proven their business viability and are wanting to expand their operations.

Who stand to gain from Venture Capital (VC) funding?

1. Startups
2. Innovative enterprises who are still in the early stages of their growth

3. High risk – high reward business lines
4. Niche business segments, etc.

In the Indian scenario, the e-commerce segment has seen sustained interest for funding by VCs, for example:

1. Online services like Makemytrip, Taxi For Sure etc.
2. Online marketing portals like Bookmyshow, Myntra, etc.
3. Online health care segments like Practo, etc.

2.1.2 Business Model for a VC

So, what is the business model for a VC? The first and the foremost step will be to identify a startup or a diverse idea that can become a revenue generator and hence warrants capital funding. And this is the toughest part of the job. The selection matrix can involve a whole battery of parameters, the critical ones listed as below:

(i) The fundamental 'idea' or the 'business model' of the company

(ii) The ability to generate customer interest thereby increasing the possibility of a successful business manifold – which explains why e-commerce companies in India are able to garner a largesse of the VC funds

(iii) The breakeven point – obviously the shorter the time frame the better

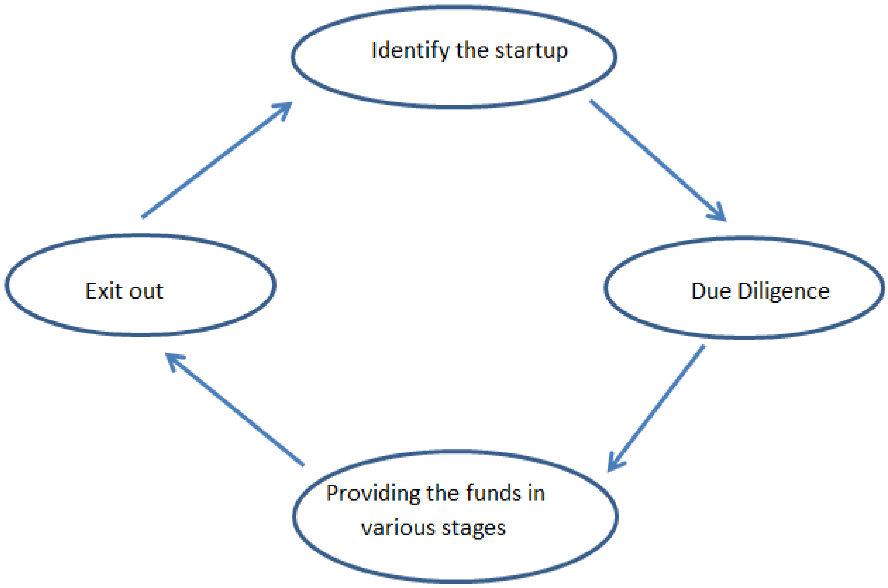
(iv) The future prospect of the startup to be taken over by a bigger entity.

Apart from the revenue perspective, a smart VC also looks into the possibility of how much can a startup create 'brand recall value' – the higher the possibility the more is the prospect of a valued takeover deal. For example, WhatsApp, in which VCs had strategic stake, had so correctly marketed the concept that it got the attention of Facebook.Its acquisition by Facebook has brought smiles to everyone involved – the VC got a good price, and so did the founders of the company, and Facebook have its customer connect significantly enhanced.

The next important step would be to measure the exact amount of capital to be provided to the venture. This would entail the need to check the background of the promoters, business culture, current and future growth prospects, cash flow estimates, breakeven point analysis, and the brand value creation. This whole process can also be called as 'due diligence' process, and finally the VC will make an exhaustive report of the same, to justify the decision to finance the venture / enterprise or otherwise.

And the last step would obviously be the exit point of the VC from the enterprise. It's very important to appreciate the fact the primary objective of any VC is to provide funds with a clear cut time frame for returns on investment. Once the desired returns are achieved, the VC exits out of the enterprise, either through a stake sell-out, or through outright merger with an outside enterprise.

The following is a pictorial representation of the basic VC investment cycle:



As stated earlier, once the target returns are achieved, the VC would like to exit out to realize the gains and move on to another investment. This brings us to the concept of 'private equity'.

2.1.3 Types of Funding by a VC

A VC will fund typically in the following ways:

1. Seed Capital
2. Startup funding
3. Early stage funding
4. Interim funding - Bridge financing , mezzanine
5. Expansion funding

Let's analyze each of these in detail:

1. *Seed Capital*: This is the preliminary source of fund provided to the startup for either acquiring fixed assets of startup like computers, machineries etc; or for leasing out premises and such other operational setups. The seed capital is usually limited, and just enough for the startup to shore up its capital assets. In the recent times, there are 'incubators' who have specialized into this type of funding purely for seed capital, and seek to exit out once other investors find value.
2. *Startup funding*: This funding is given usually for the purposes of executing sales orders, in terms of product development and sales, doing sales promotional activities and the like.

3. *Early stage funding*: This is typically the Series A funding where the VC provides the funds for setting up the entire plant / site / services line which may also include the infusion of working capital.

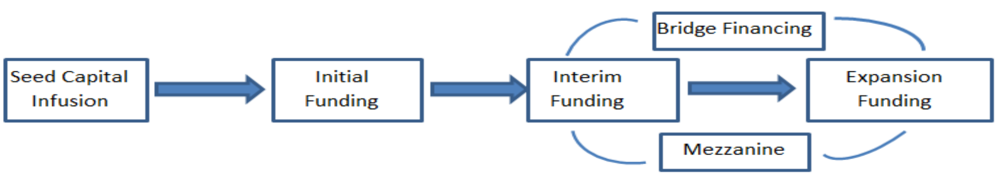
4. *Interim funding*: Once the enterprise breaks even, the immediate focus will be on having stable cash flows. In the meantime, the management may also seek additional capital to ramp up its' operations model to its full capacity. This can be done in different ways –

   a. The management can seek a 'bridge loan' that is essentially a plank provided for stepping up to ramp up / reach the full capacity. Bridge loan, being a short term financing loan, is an ideal way for enterprises to get a temporary source of funds before it can get replaced with a larger or a longer time frame based loan.

   b. The management can seek a 'mezzanine' financing which is typically a hybrid of debt and preferred stock finance. In some cases, the mezzanine is purely a debt form of finance. In both cases, the repayment schedule gets tailored to the enterprise's cash flows thereby exhibiting flexibility to the management. However, the fund comes at a price – the VC gets a direct stake in the equity of the enterprise post the conversion of preferred stock, which may make some management uncomfortable for this sort of an arrangement. There are variants of mezzanine funding with some VCs who estimate that if the enterprise has high future potential, it can forego the requirement for a collateral value altogether or atleast keep it to minimal levels; whereas some VCs would like to have an asset-backed security for the debt component. The equity component also gives the VC a say in the management affairs of the enterprise, which makes this route quite attractive to them. From the borrowers' point of view, this may be the costliest form of funding as the rate of interest would be quite high, to recognize the risks getting carried in the form of uncollateralized debt. This can leave the management with a huge refinance cost; however, as stated earlier the VC would also take care of this in the tailoring of the repayment schedule.

5. *Expansion funding*: Once the enterprise is running full steam, and has managed to create its own space in the market in terms of brand recall value, the VC will surely be interested to provide additional funding in terms of long term finance for future growth prospects. This may also put the enterprise 'on the block' for potential buyers, especially large sized companies who regularly scout for smaller niche enterprises for adding further variety to their developed shelf of products and services.

The following is a pictorial representation of the VC funding stages:



2.1.4 Angel Investor

An angel investor is a multi-millionaire who has the funds, usually idle with him or her, and wants to take a share of risk to promote a startup by investing into the same. In return, they usually get an ownership stake or a preferred stocks and board rights. Seldom do they settle for subordinated debt, unless the case for investment is too strong to an opportunity to be missed. The biggest pitfall for an angel investor is that they need to bear extremely high risks, and hence their rate of returns is also the highest. Usually angel investors are retired fund managers and successful entrepreneurs themselves who have a knowhow of the particular segment that they would like to invest in, and rely a bit more on intuition and gut feel about a particular investment. After all it's their own funds, as compared to VC funds who manage other's funds. It is not uncommon to find angel investors having common segment interest to team together, such as two investors having a liking for e-retailing space would definitely approach for an assessment of a particular enterprise together. This has also given rise to a new concept called 'equity crowd sourcing' – online social media like Facebook, LinkedIn have been fuelling this concept of crowd sourcing or crowd funding, however given the fact that the gullible investors can fall prey to fly-by-night operators; US has brought the JOBS Act (the acronym JOBS is abbreviated for 'Jumpstart Our Business Startups Act'), which has been conditionally adopted by the US regulatory authority which is Securities Exchange Commission (SEC).

2.2 Buyouts for a PE

A PE would have a horizon estimate put to its investment. However, usually they are actively assessing for obtaining a good value informally within their business circles, at times, even a year before the planned exit date. There are two popular ways of buyouts getting executed – Leveraged Buyouts (LBOs) and Management Buyouts (MBOs).

2.2.1 Leveraged Buy Outs (LBOs)

The increasingly complex nature of commerce and its applications have given rise to a new category of 'strategic investors' – private equity (PE) firms who scout for enterprises in the 'rough', acquire the same using a clever mix of debt and equity (typically at 70:30 debt to equity), and then targeting to sell the same within a medium term period, say 3 to 5 years. In the process, they leverage on the debt and create value (both perceived and real) and then they either spin off the management control to another entity for a price, or go for an outright sale.

Some of the examples of a successful LBO deal include the buyout by Tata Steel of UK's Corus, and the acquisition of SLI Sylvania by Havells India.

2.2.2 Management Buy Outs (MBOs)

The classic MBO represents the buyout made by the entity's managers themselves. The logical reasoning is that they are best placed to run the operations efficiently. However the other side to this is that the managers of the entity may not be the best of the lot to bring in additional clients. Similarly, they may be on the conservative side when it comes to risk taking.

However, with changing times, MBOs are also getting attention from PEs themselves. In an article published in *The Hindu Business Line* print edition dated July 10, 2008, explaining on the emerging features of MBOs - 'Traditionally, Management Buy Outs (MBOs) involved the management wanting to purchase a controlling interest in the company and working along with financial advisors to fund the change of control. Today, MBO activities involve promoters divesting their stake in a firm by selling out to PE players willing to finance the asking price. The PE players are flexible enough to enter into a partnering relationship with the existing management. This sort of arrangement is basically just a stake buyout and not a classical MBO. It is common in scenarios where owners want to hive off entities with poor results and the management lacks funds to hold on to the entity (and their jobs) and are, in turn, bailed out by the PE firm'. This means that the PE brings in the finance as well as their clout in the market to attract additional business lines. Once the expected IRR is achieved, or the estimated cash-on-cash multiple is attained, the PE may also chose to exit out. One of the good examples of MBO in India is the purchase of Intelenet Global Services by Blackstone.

2.3 Hurdle rate

The minimum rate of return that is required by the investor before the sharing of profits – for e.g. a hurdle rate of 15% would mean for the PE that this should be the minimum return to be generated before sharing of profits start. In other words, the hurdle rate is the minimum guaranteed return for the Limited Partners before sharing the gains with the General Partners, as per the carried interest arrangement. Carried interest or simply stated as 'carry' is the share of profits of the General Partner in excess of the investment made by him in the portfolio.

2.4 Paid in Capital

Paid in Capital is the amount of capital contributed by the shareholders. It is amount of capital "paid in" by investors during the issue of equity shares to the public, including the par value of the shares themselves. Paid in capital represents the funds raised by the business from equity, and not from ongoing operations." "Paid-Up Capital is shown in the 'equity' section of the balance sheet. It represents the amount of money shareholders have paid into the company by purchasing shares. It basically involves two accounts, the par value of the shares and the excess over par value.

2.5 Term Sheet

The term sheet is the agreement copy that the VC hands over to the management, which contains the terms and conditions, fee structure, payout terms, liquidation rights, anti-dilution provisions, pre-emptive rights, exit terms etc.

Critical Terms that appear in a Term Sheet:

(i) **Fee structure**: The VC will have two types of fee income it earns – a management fee that is based on a fixed percentage, and a 'carry'. The management fee will vary from 1% to as high as 5%, the normal standard being 2% of the total invested funds in the particular venture. It is not unusual to also find a tapering clause in the fee structure after a specific period, say three years, post which the fee percentage starts shrinking to the harvest year. On the other hand, a 'carry' clause would mean a 'carried interest' in the profits of the venture either for a certain pre-determined number of years, or till harvest. The GP (General Partner) usually stands to earn a portion of both management fee as well as carry. Carried interest gets payable after the hurdle rate is achieved.

(ii) Harvest year: The year projected to be the exit year for the PE/VC.

(iii) Down round: This would mean that the investors pay a lower per share price than what previous investors paid, which indirectly implies that the investors have valued the VC at a lower value in the current round than the previous round. This decline is called as 'down round'. For example, if the initial round of financing earned INR 1 Crore for an entity, and the round two has obtained a value of INR 0.7 Lacs, then this means that the investors have valued the entity lower in the second round, causing a 'down round'. Down round causes a dilutive effect of original investor rights.

(iv) Methods for computing anti-dilution rights: To avoid a possible dilution to a 'down round' situation, the term sheet will usually contain an anti-dilutive clause. This is achieved either by a 'full ratchet' method or a 'weighted average' method, and the preferred method is mentioned in the term sheet. In a rare case where it is not explicitly stated, the weighted average method is usually adopted.

Illustrative example on the application of anti-dilutive clause:

The position of holding in a VC before the second round (Series B) -

	Number of Shares	Per share	Value	% holding
Common Stock	600,000	1.00	600,000	60%
Series A investor	400,000	1.00	400,000	40%
	1,000,000	**1.00**	**1,000,000**	**100%**

Now, in Series B an investor has given a down round value of only INR 6, 00,000. Without an anti-dilution clause, the revised stake-holding would be as:

Common Stock	300,000	0.60	180,000	30%
Series A investor	200,000	0.60	120,000	20%
Series B investor	500,000	0.60	300,000	50%
	1,000,000		600,000	100%

You would note that the share of Series A investor has gone down, whereas the late entrant Series B investor has an upper hand.

Now, say if there was an anti-dilutive clause which stated to protect Series A investor against a down round – the revised sheet would look as below –

	Number of Shares	CP	Value	% holding
Common Stock	100,000	0.60	60,000	10%
Series A investor	400,000	0.60	240,000	40%
Series B investor	500,000	0.60	300,000	50%
	1,000,000		600,000	

(v) Up round: The opposite of down round where the successive round of investment has valued the venture at a value higher than the earlier round.

(vi) Break Fee: A fee typically payable to the investor if the company declines the investment described in the Term Sheet or if the company or founders breach exclusivity or other binding provisions in the Term Sheet.

(vii) Exclusivity Agreement: A kind of non-compete period during which the company cannot negotiate for investments with outsiders for additional investments in the company. This is to protect the holding rights of the PE.

3. COST OF INVESTING IN PRIVATE EQUITY

The cost of investment for a PE will be economically the same as seen for a VC, barring for the capital cost in specific cases. However, given that the PEs are strategic equity holders, they would always prefer to hold the investment using a holding-subsidiary company structure. This would help them to exercise the control from outside without involving in the day-to-day operations of the subsidiary as well as in maintaining arm's length as there can be more than one strategic investor too. As per the Companies Act 2013, the holding company will enjoy a majority status if it has more than 50% of the total share capital of the subsidiary or exercises 'control' over the composition of the board of directors.

4. EXIT ROUTES FOR A PE

There are four ways to exit out of a PE investment once the horizon period is met, or otherwise by management decision.

(i) IPO (initial public offer): This represents a highly successful exit strategy, riding on a strong business model. The payback can be instantaneous through selling the own shares immediately on listing on the stock exchange.

(ii) *Strategic Acquisition:* The share of the PE is acquired by a larger company usually in the same business segment. Thus, a small IT company into a niche testing technology line may get acquired by a bigger IT company, which is often seen in India. Another example can be the acquisition of Instagram by Facebook. This is perhaps the most commonly used exit route, and is usually a win-win situation for both the exiting investor as well as the management of the enterprise.

(iii) *Secondary Sale:* The investor PE exits by transferring its share to another PE. Such an exchange is seen either when a larger PE finds value in the venture thereby giving a sweetened deal to the smaller PE, or, where the business may require more money which is not in the capacity of the current equity fund.

(iv) *Repurchase by existing management (founder members):* This is an ideal scenario type where the founders get back to owning the majority stake in their entity, and a golden hand-shake to the exiting PE. This is also referred to as 'Management Buyout' (MBO). The exiting PE may, in rare cases, also get to earn a trail fee for the next *n* years as may be mutually agreed to by the parties, usually a % of EBIT, or a multiple based terminal value.

(v) *Liquidation:* This is the least preferred method of exit, where the investor leaves out at a cash loss on capital invested. This usually happens where the investor cannot take further losses, or had made an over-estimate of expected returns, or a particular idea behind the venture hasn't really taken off, or well received in the market. The term sheet usually provides financial safeguards to the VC against drastic losses.

5. VALUATION OF PRIVATE EQUITY TRANSACTIONS

There are certain terminologies that are intrinsic to valuation exercises performed by VCs / PEs,these includes:

(i) Pre-money and post-money valuation: Simply put, pre-money valuation is the value of the enterprise before the investment; and post-money is the valuation after the investment by the VC. For example – assume a startup has a share capital of ₹ 10,000 represented by 1000 equity shares of Rs. 10 each. X, a VC, has shown interest to do an initial funding of ₹ 4000 worth represented by 400 equity shares.

In this case the pre-money valuation is INR 10,000 (before investment). The post-money valuation will be the fully diluted impact on the equity which will be computed using the following formula:

New Investment Amount* (Total shares post investment ÷ Shares issued in new investment)

In the example, the post-money valuation will as –

	Number of shares	Face Value	Valuation
Pre-money	**1000**	**10**	**10,000**
Post-money			

Existing	1000	10	10,000
New Investment	400	10	4,000
Post-money shares outstanding	**1400**	**10**	**14,000**
Post-money Valuation			**14,000**

Note: The above illustration is a simplistic representation of how pre and post money valuation works in mathematical terms. In real life, the VC would perform a valuation based on due diligence and the value would either be at a premium or discount.

(ii) Ownership dilution: Each additional investment from the VC will end up diluting the ownership control of the management of the enterprise. In the example above, the effective ownership control of management has gone down from 100% to 71.43%. If there is a further round of investment, the management control even will well go below 50%. Anti-dilution clauses are mandated in the term sheet to help overcome this problem. The number of shares to be issued will be adjusted to maintain the ratio of holding.

(iii) Liquidation Preference: It is an important term associated with Private Equity financing. This term provides preference to receive fund by VC over and above preferred and common stock holders in the event of liquidation or deemed liquidation.

(iv) Series A and B: Series A will be the initial round of funding, whereas Series B are the subsequent rounds of funding, which are usually after the enterprise achieves certain pre-determined milestones.

(v) ROI: The rate of return that the enterprise would offer to the investor (VC) on the investment.

(vi) Terminal Value: The value of the enterprise that would be at the end of the time frame of the investment cycle of the VC, used at the time of acquisition / sale to a third party. An Exit Multiple would be used, usually calculated as on Enterprise Value (EV/EBIDTA), that the VC has been expecting to obtain at the exit through selloff.

(vii) Tranches: The investor (PE or VC etc.) will bring the funds only based on certain agreed 'milestones'. The funding is, thus, made in parts or 'tranches'.

(viii) Deemed Liquidation: This term implies in addition to liquidation, it includes change of control, acquisition, amalgamation etc., sale of a company or sale of most of its assets. As mentioned above deemed liquidation normally are considered trigger events for liquidity preferences.

6. PRIVATE EQUITY FUNDS (DISTRIBUTION OF RETURNS IN GENERAL PARTNER AND LIMITED PARTNERS)

The terms General Partner and Limited Partner are generic to PE world, and represent the way the stakeholders and their rights are structured within the PE. The PE fund is structured as a liability partnership; and General Partner (GP) is the one who represents the PE firm in terms of raising the capital from a basket of pension funds, angel investors, HNIs (high- net worth individuals), and the Limited Partners (LPs) are these investors (pension funds, angel investors etc) who have invested with the GP. The GP acts like the investment / fund manager and will formulate the investment portfolios (the enterprises where the PE will invest funds), and also determine the 'capital commitment' by the LPs.

For e.g.: A PE looking to fund an enterprise into e-retailing (portfolio) will have its GP approaching its pool of LPs and, say, if a couple of LPs agree to investing the sum required, then this becomes the capital committed from the LPs end. One practical scenario will be that the investments are not required in one go – it will be in tranches –and hence there will be 'calls' raised by the GP for fund requests from the designated LPs (two in our case). Suppose if one of them doesn't honor the call, the GP normally has the right to forfeit the amount invested by the LP to that point of time, unless the agreement specifically states otherwise, or allows for a 'replacement' by another LP who would purchase at a discount the existing share. The GP will usually stand to earn through 'management fee' which will be a % fixed on the deal amount and through 'incentive fees' – called hurdle rates.

Conclusion

We have seen that venture capital funds and PEs fill in the capital requirement gap of new emerging technologies and innovations. In matured markets like US, PEs does play a significant role in funding such segments. In India, VCs and PEs are still in evolving stages though e-commerce companies have certainly progressed due to their innovative entry and exit strategies. VCs work towards short and medium term goals, whereas PE funds stay put for the long run. However, both have well defined exit strategies, typically through acquisitions or IPO mode. In India, they come within the ambit of SEBI and have to follow the established rules and procedures for equity sourcing and funding.

CHAPTER 11

INVESTMENT BANKING

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Concept
- Functions
- Challenges
- Developments in Investment Banking
- Merchant Banking and Issue Management

1. CONCEPT OF INVESTMENT BANKING

An investment bank is basically a financial intermediary between the issuer and the investor of securities. It's primary task is to sell securities on behalf of a company and underwrites the issue of new equity shares to raise the necessary capital for the company.

In order to expand their businesses, companies need money. The company does this by selling their securities to investors. Investment bankers help the corporates in this respect. So, we can say that investment bankers are basically financial intermediaries who help their clients in raising capital either by underwriting their shares or bonds or by acting as an agent in the issuance of securities.

Further, it has to be noted that Investment banking isn't a specific function. It is a term used for a range of activities including underwriting, selling and trading securities; providing financial advisory services, such as mergers and acquisition advice; divestitures, private equity syndication, IPO advisory and managing assets.

1.1 The main players in Investment Banking

The biggest investment banks in global scenario include Goldman Sachs, Bank of America Merrill Lynch, Morgan Stanley, Salomon Smith Barney, Donaldson, Lufkin & Jenrette, Credit Suisse, Deutsche Bank, Citi, Barclays Capital, and J.P. Morgan among others.

1.2 Main areas of Investment Banking

Generally, the breakdown of an investment bank includes the following areas:

1.2.1 Corporate Finance

The corporate finance, generally perform two different functions:

(i) Mergers and Acquisitions Advisory and

(ii) Underwriting.

(i) Mergers and Acquisitions Advisory: Under this aspect of corporate finance, investment banking help in negotiating and structuring a merger deal between two companies. For instance, if a company wants to buy another company, it may take the help of an investment banker who will assist in finalizing the purchase price by coordinating with the bidders, performing due diligence, structuring the deal, negotiating with the merger target and generally ensuring a smooth transaction.

Moreover, mergers and acquisition advisory includes buy side and sell side advisory. However, sell side advisory holds the key because Investment Banker helps in placing the stocks and bonds in the public platform and sell these to investors. This selling aspect helps the companies to generate funds and consequently assists in expanding the corporate finance division of investment banking.

(ii) Underwriting: Under the underwriting function, underwriters help their client companies in raising the required funds for the company. Whenever, a corporate wants to raise capital, it takes the help of underwriters who purchase the unsubscribed portion not taken by the investors. Underwriting can be done either through negotiations between underwriter and the issuing company (called negotiated underwriting) or by competitive bidding. A negotiated underwriting is a negotiated agreed arrangement between the issuing firm and its investment banker. Most large corporations work with investment bankers with whom they have long-term relationship. In competitive bidding, the firm awards offering to investment banker that bid the highest price.

1.2.2 Sales

Sales is an important part of any investment bank. The main task of the sales force of an Investment bank is to enable high net worth individuals and institutions to take orders from them. They make money through commissions received from their clients.

They make buy and sell recommendations. For example, if the share price of ABC Ltd. is on the higher side, the sales guy of the investment bank will recommend buying the shares of that company.

1.2.3 Trading

Trading plays an important part for the investment bankers. Clients order is communicated to the trading people by the sales people. Traders help their client in buying and selling of shares, bonds, currencies etc. It also helps them in executing a trade.

Traders tackle all type of transaction, big or small and provide liquidity to the market. They generally make money by purchasing securities at lower price and selling them at a higher price.

Sales force of an Investment bank and traders also delve into propriety trading. Propriety trading is a form of trading in which the traders trades in stocks, bonds, derivatives in its own account using their own money. They do not touch client's account. The main advantage of this form of trading is that the traders can take the entire profit from the investment made. Otherwise, in other forms of trading they have to depend upon commission from their clients. The chances of making excess profits in this form of trading are much higher since the traders have the necessary expertise which an average investor doesn't have.

In case of IPOs and follow-on offers, an investment bank's sales and trading department keeps the communication channel open with the corporate finance department of the company. Generally, it is the responsibility of the sales and trading department of the investment banks to build books for a particular stock. After that, on the date of offering, they fixed the price of the shares and start selling the new shares to their customers.

1.2.4 Research

Research analysts analyses the stock and bonds of various stocks and recommend whether to buy, hold and sell those securities. The job of research analyst is to review the company and wrote a report on the prospectus of a company and gives a buy and sells rating. Some research analyst focuses on equity while some give its attention to fixed income securities such as bonds.

Actually, research activity by itself does not generate a lot of income. The recommendation of research workers influences the buying and selling of securities of a company. Because of this, the sales and trading people earns more fees. So, reputable research analyst are a very important part of an investment banking team as they help them in increasing their business and earn a hefty income.

1.2.5 Syndicate

The hub of the investment banking wheel, syndicate provides a vital link between salespeople and corporate finance. Syndicate exists to facilitate the placing of securities in a public offering, a knock-down drag-out affair between and among buyers of offerings and the investment banks managing the process. In a corporate or municipal debt deal, syndicate also determines the allocation of bonds.

In certain cases, for large or risky issues a number of investment bankers get together as a group, they are referred to as syndicate. A syndicate is a temporary association of investment bankers brought together for the purpose of selling new securities. One investment banker is selected to manage the syndicate called the originating house, which does underwriting of the major amount of the issue. There are two types of underwriting syndicates, Divided and Undivided. In a Divided Syndicate, each member group has liability of selling a portion of offerings assigned to them. However, in Undivided Syndicate, each member group is liable for unsold securities up to the amount of its percentage participation irrespective of the number of securities that group has sold.

The breakdown of these fundamental areas differs slightly from firm to firm, but typically an investment bank will have these areas.

1.3 Commercial Banking vs. Investment Banking

Inspite of sharing many aspects, commercial banking and investment banking contains some fundamental differences. After a quick overview of commercial banking, we will build up to a full discussion of what investment banking entails.

1.3.1 Commercial Banks

The job of commercial banks is pretty simple. They take deposits from the customers and then lend that deposited amount to consumers. If one wants to borrow money to buy a house, car, or for any of his personal purposes, he will approach a commercial bank. Also, the companies that borrow from commercial banks range from a small shopkeeper to a large multinational company.

If anyone wants to take loans from banks, they contact them and enter into a legal contract. Generally, a negotiation takes place in which the banks pursue their customers individually to determine the terms of the loans, including the time to maturity and the interest rates to be charged.

1.3.2 Investment Banks

The functioning of investment bank is different from a commercial bank. An investment bank does not lend from its cash reserve of deposits accepted from its customers as does a commercial bank. In fact, an investment bank acts as an intermediary and undertakes the matching of buyers and sellers of stocks and bonds.

However, the main purpose of companies to utilize the services of commercial banks and investment banks are the same. Whenever, the companies need funds, they contact the commercial banks for loan or an investment bank to sell their stocks or bonds. However, the investment banks have to comparatively work harder and spent sufficient time to find investors so that it’s client company can get the required capital.

Investment banks typically sell public securities as opposed to private loan agreements initiated by commercial banks. Technically, for example, securities such as stock of TCS or Mahindra and Mahindra Financial Services AAA bonds, represent a high degree of safety and are traded either on a public exchange or through an approved dealer. The dealer is the investment bank.

The investment bank makes money by charging the client a small percentage of the transaction upon its completion. This is generally called "underwriting discount." However, a commercial bank making a loan actually receives interest on the money lent by it.

Thus the fundamental differences between an investment bank and a commercial bank can be outlined as follows:

Investment Banks	Commercial Banks
1. Investment Banks help their clients in raising capital by acting as an intermediary between the buyers and the sellers of securities	1. Commercial Banks accept deposits from customers and lend money to individuals and corporates
2. Investment Banks do not take deposits from customers	2. Commercial banks can take deposits from customers.
3. The Investment Banks do not own the securities and only act as an intermediary for smooth transaction of buying and selling securities.	3. Commercial Banks have the ownership of loans granted to their customers.
4. Investment Banks earn underwriting commission	4. Commercial banks earn interest on loans granted to their customers.

1.3.3 Public Securities

Investment banks typically sell public securities (as opposed private loan agreements). Technically, securities such as Microsoft stock or Tata Steel AAA bonds, represent a high degree of safety and are traded either on a public exchange or through an approved dealer. The dealer is the investment bank.

Let's look at an example to illustrate the difference between private debt and bonds. Suppose ITC Ltd, the FMCG conglomerate needs capital, and estimates its need to be ₹ 2000 million. *ITC has two choices:*

(a) It could obtain a commercial bank loan from State Bank of India for the entire ₹ 2000 million, and pay interest on that loan.

(b) It could sell bonds publicly using an investment bank such as Merrill Lynch. The ₹ 2000 million bond issue raised by Merrill would be broken into many bonds and then sold to the public. (For example, the issue could be broken into 20,00,000 bonds, each worth `1,000.) Once sold, the company receives its ₹ 2000 million and investors receive bonds worth a total of the same amount. Over time, the investors in the bond offering receive coupon payments (the interest), and ultimately the principal (the original ₹ 1,000) at the end of the life of the loan, when ITC buys back the bonds (retires or redeem the bonds). Thus, we see that in a bond offering, while the money is still loaned to ITC, it is actually loaned by numerous investors, rather than a single bank.

As the investment bank involved in the offering does not own the bonds but merely placed them with investors at the outset, it earns no interest - the bondholders earn this interest in the form of regular coupon payments. The investment bank makes money by charging the client (in this case, ITC) a small percentage of the transaction upon its completion. Investment banks call this upfront fee the "underwriting discount." In contrast, a commercial bank making a loan actually receives the interest and simultaneously owns the debt.

2. FUNCTIONS OF AN INVESTMENT BANK

2.1 Issue of IPO

Companies in need of funds resort to Initial Public Offering (IPO). This is the phase when securities are issued to the public for the first time. After the initial public offering, securities are listed on the stock exchange and sale and purchase of those listed securities can take place. The task of investment bankers in this regard is to underwrite the public issue by charging some commission.

Further, commercial banks have also developed expertise in underwriting public bond deals. So, commercial banks not only lend money by utilizing depositor's money but also they underwrite bonds through their corporate finance department. So, the commercial banks have directly competed with investment banks for this business of bond underwriting. But, in reality, only a handful of big commercial banks are able to compete in this business with the investment banks that generally have a larger share of the pie.

From the perspective of an investment banker, the IPO process consists of two major phases: hiring the managers and due diligence.

(i) Hiring the Managers: Before going for a public issue, the first task that the company does is to hire a merchant banker for the issue which is also called a manager to the issue. The selection process depends upon the investment banker's general goodwill, expertise as well as the quality of its research coverage in the company's specific industry. The selection also depends on whether the issuer would like to see its securities held more by individuals or by institutional investors. Almost all IPO candidates select two or more investment banks to manage the IPO process.

When there is more than one investment bank, one among them is selected as the lead or book-running manager. The lead manager almost always appears on the left cover of the prospectus, and it plays a major role throughout the transaction. The task of the manager is to make all arrangements with the issuer, make the schedule of the issue and fulfills all the requirements of the due diligence process. He is also responsible for the pricing and distribution of the stock.

(ii) Due Diligence and Drafting: Once managers are selected, the second phase of the process begins. For investment bankers on the deal, this phase involves understanding the company's business as well as possible scenarios (called due diligence), and then filing the legal documents as required by the SEBI.

The merchant banker would be closely associated in preparing the new applicant's prospectus and other related listing documents. The Merchant Banker shall conduct a due diligence on the applicant and provide due diligence certificate as per Form A of Schedule VI of the ICDR including additional confirmations as provided in Form H of Schedule VI along with the offer document to the exchange. The other certifications as mentioned in ICDR, Schedule VI will be provided, if applicable. *[Source: www.nseindia.com]*

2.2 Follow-on offering of stock

Sometimes an already listed company issue shares to the public again. This is called a Further Public Offer or Follow-on Offering. The main reason for a company to go through this offer is that – it is growing rapidly and it needs funds for that.

2.3 Issue of Debt

Sometimes, the company instead of choosing equity for their funding requirements chooses public debt.

The reasons for issuing bonds rather than stock are explained as follows:

(a) When the stock price of the company is down, a bond issue is a better alternative.

(b) The firm does not want to dilute its existing shareholding by issuing more equity.

These are both valid reasons for issuing bonds rather than equity.

Further, in case the economy is not doing well investors generally avoid the share issue and in such cases issuance of bonds may be resorted to satisfy the company’s appetite for funds.

In case of a bond issue, the focus of the prospectus is on highlighting the importance of the company’s stability and steady cash flow. On the other hand, a share issue prospectus will highlight the company’s growth and expansion opportunities.

In case of a debt issue, the importance of a bond's credit rating cannot be undermined. It is necessary to obtain a good credit rating from a reputed credit rating agency like CRISIL, ICRA, CARE etc. So, better credit rating gives an impression that the bond is safer. In order to encourage investors to receive lower rate of interest, the credit rating of debt issue should be high.

2.4 Merger and Acquisitions (M&A)

M&A advisors come directly under the corporate finance departments of investment banks. As in the case of public offerings, merger and acquisition transactions do not directly involve salespeople, traders or research analysts. Particularly, M&A advisory comes under the domain of M&A specialists and fits into one of either two: seller representation or buyer representation (also called target representation and acquirer representation).

Representing the target	Representing the acquirer
Sell-side representation is used when a company asks an investment bank to help it to sell a division, plant or subsidiary operation. In this respect, the first step is to write a selling memorandum and then contact the future buyers of the client.	Under this approach, the investment bank contacts the parties who wish to purchase. The investment banker also attempts to prepare an offer which can be feasible for all parties and helps to crack the deal.

2.4.1 Buy Side Advisory

The Investment Banks provide advisory services to clients who have identified particular companies which are to be acquired and help them in negotiating, due diligence, financing and documentation of the transaction. These are being divided into following four steps for easy understanding:

Short-listing of companies to be acquired – In this step, the investment banker helps its client companies to short list the companies to be acquired. To extend this service, it uses its network of relationships with companies, private equity funds and other intermediaries to identify the suitable companies that are to be acquired.

Preparing and executing Term Sheet – After the companies are shortlisted, the investment banker prepares term sheet which includes all the terms and conditions of the merger transaction. It then facilitates negotiations with the target company and ensures that the term sheet is entered into by the client with the target company.

Due Diligence – The next step is due diligence which means investigating the deal from legal, commercial and financial point of view. It basically includes verifying assets and liabilities, identifying risks, knowing the amount of risk involved and protection against such risks.

Transaction Closure – After the completion of the due diligence process, the investment banker negotiates on the final agreement with the target company to close the merger and acquisition deal. It also arranges finance for the deal, if required.

2.4.2 Sell Side Advisory

The Investment Banks helps the client companies in identifying suitable buyers which may include private companies, public companies, private-equity funds, hedge funds and international buyers. These are also being divided into following four steps for clarity of the process involved:

Preparation of information – An investment banker helps in the preparation of information on the purchasing companies' business profile which helps to present the deal in a structured manner in front of the potential acquirers.

Target short-listing – After going through the client companies extensively and short listing of potential buyers, the investment bankers enables the client company chooses its partner. As in the case of buy side advisory services, it uses its network of relationships with companies, private equity funds and other intermediaries to identify the suitable companies to whom the client company has to be sold.

Preparing and executing Term Sheet – In this step, the investment banker helps his client enter into a term sheet with the potential acquirer.

Due diligence and deal closure – After entering into a term sheet, the investment banker help the client in the due diligence process and negotiates with the purchaser to close the deal.

2.5 Private Placements

A private placement involves selling of debt or equity to few private parties. A private placement is different from a public offer because in case of a private placement, shares are offered to a few people instead of offering it to the public in general. Sometimes, the investment bankers advice their client to go for a private placement first and then apply for the initial public offer. The reason is that the bankers want to accumulate sufficient funds to justify the IPO.

The investment banker's work involved in a private placement is quite similar to sell-side M&A representation. The bankers attempt to find a buyer by writing the selling memorandum and then contacting potential strategic or financial buyers of the client.

Actually, the task of the investment banker is to convince the private investors to invest in the company and get the deal done. They charge fees for this service which is almost equal as is offered in the case of an IPO.

2.6 Financial Restructurings

When a company is not able to meet its obligations, the chances are that it may go bankrupt. In this situation, the company may either shut down it's operations or it can restructure and remain in business.

Financial restructuring involves renegotiating payment terms on debt obligations. It also includes issuing new debt and restructuring payables to vendors. Investment bankers in this respect provide guidance to the companies by recommending sale of assets, issuing convertible stocks and bonds, or it even advices for the sale of the whole company.

The investment bankers who are in the restructuring business generally deal with distressed companies i.e. the companies who are either going for bankruptcy or in the middle of a bankruptcy process. In this regard, the investment bankers are hired to provide a best deal for the company in the form of forgiveness of a large part of the debt. The companies are also advised to restructure its debt in the most prudent manner possible and get out of the bankruptcy process. Moreover, the bankers in the restructuring arena are also legally adept. For example "*The Insolvency and Bankruptcy Code"* has a huge impact on the bankruptcy process.

As a company involved in a bankruptcy process faces enough cash problems, the investment banks often charge minimal monthly retainers. They hope that the company will revive and they then make a substantial profit. They also make good income in case new securities are issued to pay back the old debt.

Because a firm in bankruptcy already has substantial cash flow problems, investment banks often charge minimal monthly retainers, hoping to cash in on the spread from issuing new securities. Like other public offerings, this can be a highly lucrative and steady business.

3. CHALLENGES IN INVESTMENT BANKING

Some of the challenges in the Investment Banking business are in existence due to the reason that the in 1990s broking firms, credit rating and other financial services firms are owned by the Investment Bankers. Hence, due to reasons of losing the other businesses from the company they may not be so fair in assigning the credit rating to the company concerned. Further in order to keep the favorable perception of new stock in post issue they might sell the shares (holding on behalf of their client) in the market.

Pricing in new issue is a big challenge for an investment banker as it should not only result in fair pricing but should be a win-win situation for both the investor as well as the company.

Valuation of shares for the exchange is another big challenge for the investment banker as it should be acceptable to both the companies involved in the process.

In new issue management compliance of various related law is a challenge for investment banker as any lapse at stage can bring the whole effort to a zero level and invite regulatory penalties.

4. DEVELOPMENTS IN INVESTMENT BANKING

Investment banking was a lucrative business till the arrival of the financial crisis in 2008. However, the sub-prime mortgage crisis took a toll in the global investment banks. A major reason for the crisis is that these investment banks were not under the control of either the Federal Reserve Bank or the US Securities Exchange Commission, which made it easier for them to take risks. As a result of the financial crisis worsening in late 2008, the biggest investment banks collapsed.

Bear Stearns was acquired by JP Morgan Chase in March 2008. Lehman Brothers filed for Bankruptcy and was declared bankrupt in September 2008. The Asian and European operations of Lehman Brothers were bought by Nomura and the North American Lehman operations by Barclays Capital. Merill Lynch was acquired by Bank of America for $50 billion. Goldman Sachs and Morgan Stanley converted themselves into commercial banks.

The collapse of these towering investment banks were felt in the Indian Investment Banks also. There were drop in fat fees and revenue for these banks. However, in the middle of the gloomy environment, there is opportunity for investment banks to go global with properly designed strategies.

Presently, the growth rate of Indian economy is slow but it is resilient and performing better than many developed countries in the world. Capital market is performing well. Nifty and Sensex are performing at an all-time high level. Many IPO's have successfully forayed in the year 2016-17.

However, investment can enhance their growth by exploring new and alternate markets, developing strong and long term relationship with the existing and new clients, giving quality advice to clients and assisting them in every stage of their growth, hiring qualified staff and promoting ethical behavior.

5. MERCHANT BANKING AND ISSUE MANAGEMENT

5.1 Introduction

SEBI (Merchant Banker) Regulations, 1992, define 'Merchant Banker' as any person who is engaged in the business of issue management, either by making arrangements regarding selling, buying, or subscribing, or acting as a manager, consultant, or advisor, or rendering corporate-advisory services in relation to such issue management.

In case of both the public issues and right issues, it is mandatory to appoint a Merchant Banker. The task of Merchant Banker is basically that of a facilitator or coordinator. It coordinates the process of issue management by helping the underwriters, registrars and bankers, in pricing and marketing the issue and complying with the SEBI guidelines.

Merchant Bankers are prohibited from carrying on certain activities such as acceptance of deposits, leasing and bill discounting. They are not allowed to borrow any money from the market. They are also debarred from engaging in the acquisition and sale of securities on a commercial basis.

5.2 Responsibilities of Merchant Bankers as per SEBI ICDR Regulations

5.2.1 Communication

In respect of all public communications, issue advertisements and publicity materials, the issuer shall obtain approval from the lead merchant bankers responsible for marketing the issue and shall also make copies of all issue related materials available with the lead merchant bankers at least till the allotment is completed.

5.2.2 Compliance Certificate

The merchant bankers shall submit a compliance certificate in the format specified in Part E of Schedule X, for the period between the date of filing the draft offer document with the Board and the date of closure of the issue, in respect of news reports appearing in any of the following media:

(a) newspapers mentioned in sub-regulation (3) of regulation 9;

(b) major business magazines;

(c) print and electronic media controlled by a media group where the media group has a private treaty/shareholders‘ agreement with the issuer or Promoters of the issuer.

5.2.3 Copies of offer documents to be available to public

(i) The issuer and lead merchant bankers shall ensure that the contents of offer documents hosted on the websites as required in these regulations are the same as that of their printed versions as filed with the Registrar of Companies, Board and the stock exchanges.

(ii) The lead merchant bankers and the recognized stock exchange shall provide copies of the draft offer document and final offer document to the public as and when requested.

5.2.4 Redressal of investor grievances

The post-issue lead merchant bankers shall actively associate him with post-issue activities such as allotment, refund, dispatch and giving instructions to syndicate members, Self Certified Syndicate Banks and other intermediaries and shall regularly monitor redressal of investor grievances arising therefrom.

5.2.5 Due diligence

The lead merchant bankers shall exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents.

5.2.6 Audited financial statements in the offer document

The merchant banker shall ensure that the information contained in the offer document and the particulars as per audited financial statements in the offer document are not more than six months old from the issue opening date.

5.3 Pre-Issue Management by Merchant Banker

Merchant Bankers play an important role in the issue management process. Besides the above discussions on responsibilities of Merchant Banker, Pre-Issue Management by Merchant Banker has been separately discussed in the following paragraphs to induce more clarity in the minds of the students:

(i) Entering into an agreement with Merchant Banker: An agreement has to be entered into between a lead merchant banker and the issuer company, specifying their rights, liabilities and obligations. The lead merchant banker has to submit three copies of the draft offer letter along with the copy of the agreement to the Board (SEBI).

(ii) Filing of the draft offer document and other documents: The lead manager(s) shall submit the following to the Board along with the draft offer document:

a) a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s);

b) *a due diligence certificate as per Form A of Schedule V;* The Merchant Banker shall exercise Due Diligence and submit a due diligence certificate to the Board confirming that all the disclosures made in the draft prospectus are true and fair and they are capable of ensuring that the investors take a well informed decision on that basis.

c) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per Form B of Schedule V;

(iii) Disclosures in the draft offer document and offer document

a) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer document.

b) The lead manager(s) shall call upon the issuer, its promoters and its directors or in case of an offer for sale, also the selling shareholders, to fulfill their obligations as disclosed by them in the draft offer document and the offer document and as required in terms of these regulations.

c) The lead manager(s) shall ensure that the information contained in the draft offer document and offer document and the particulars as per restated audited financial statements in the offer document are not more than six months old from the issue opening date.

(iv) Submission of Documents

The lead manager(s) shall submit the following documents to the Board after issuance of observations by the Board or after expiry of the period stipulated in sub-regulation (4) of regulation 25 if the Board has not issued observations:

a) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the offer document;

b) a due diligence certificate as per Form C of Schedule V, at the time of registering of the offer document;

c) a copy of the resolution passed by the board of directors of the issuer for allotting specified securities to promoter(s) towards amount received against promoters' contribution, before opening of the issue;

d) a certificate from a statutory auditor, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid and credited to the issuer's bank account by each of them towards such contribution;

e) a due diligence certificate as per Form D of Schedule V, in the event the issuer has made a disclosure of any material development by issuing a public notice pursuant to para 4 of Schedule IX.

(v) Availability of issue material : The lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, and self-certified syndicate banks before the opening of the issue.

(vi) Undertaking: The merchant banker shall also submit an undertaking that transactions in securities by the promoter between the date of filing of offer documents with Registrar of Companies (ROC) and the date of closure of issue shall be reported to the stock exchange within 24 hours of the transaction.

(vii) Appointment of Intermediaries: The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with the Board after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.

(viii) Underwriting: The merchant bankers shall satisfy themselves about the ability of the underwriters before their appointment. In respect of every underwritten issue, the merchant banker shall undertake a minimum underwriting obligation of 5% of the total underwriting commitment or 25 lakhs, whichever is less.

In case of a book built issue, the following requirements as to Underwriting shall be undertaken by the merchant banker:

(a) The lead manager(s) shall compulsorily underwrite the issue and the syndicate member(s) shall sub-underwrite with the lead manager(s).

(b) The lead manager(s) / syndicate member(s) shall enter into underwriting/ sub underwriting agreement on a date prior to filing of the prospectus.

(c) The details of the final underwriting arrangement indicating actual numbers of shares underwritten shall be disclosed and printed in the prospectus before it is registered with the Registrar of Companies.

(d) In case of an under-subscription in an issue, the shortfall shall be made good by the lead manager(s) and the same shall be incorporated in the inter-se allocation of responsibility as specified in Schedule I.

(ix) Offer document to be made public

(1) The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, Board and the SME exchange(s).

(2) The lead manager(s) and the SME exchange(s) shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

(x) Appointment of Compliance Officer: The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

(xi) The merchant banker shall also ensure that the issuer company has entered into an agreement with depositories for dematerialization of securities.

5.4 Post Issue Management by Merchant Bankers

Post Issue Management by Merchant Bankers has been explained in detail as below to enable the students to have more clarity on the topic:

5.4.1 Allotment, refund and payment of interest

(1) The issuer and lead manager(s) shall ensure that the specified securities are allotted and/or application monies are refunded or unblocked within such period as may be specified by the Board.

(2) The lead manager(s) shall ensure that the allotment, credit of dematerialised securities and refund or unblocking of application monies, as may be applicable, are done electronically.

(3) Where the specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated in sub-regulation (1) above, the issuer shall undertake to pay interest at the rate of fifteen per cent per annum to the investors and within such time as disclosed in the offer document and the lead manager(s) shall ensure the same.

5.4.2 Post-Issue Advertisements

The lead manager(s) shall ensure that an advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the registrar, date of credit of specified securities and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

5.4.3 Post-Issue responsibilities of the lead manager(s)

(1) The responsibility of the lead manager(s) shall continue until completion of the issue process and for any issue related matter thereafter.

(2) The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.

(3) The lead manager(s) shall continue to be responsible for post-issue activities till the applicants have received the securities certificates, credit to their demat account or refund of application monies and the listing agreement is entered into by the issuer with the stock exchange and listing or trading permission is obtained.

(4) The lead manager(s) shall be responsible for and co-ordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from syndicate member(s) or collecting bank branches and/ or self-certified syndicate banks, processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, credit of the specified securities to the demat accounts of the allottees and unblocking of ASBA accounts/ despatch of refund orders are completed and securities are listed, as applicable.

(5) Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to the Board.

(6) In case there is a devolvement on the underwriters, the lead manager(s) shall ensure that the notice for devolvement containing the obligation of the underwriters is issued within ten days from the date of closure of the issue.

(7) In the case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to the Board, in the format specified in Schedule XVIII.

5.4.4 Post-issue reports

The lead manager(s) shall submit a final post-issue report as specified in Part A of Schedule XVII, along with a due diligence certificate as per the format specified in Form F of Schedule V, within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure of issue.

5.4.5 Coordination with Intermediaries

The post issue lead merchant banker maintains a close coordination with Registrar to the issue, and deputes officers at the offices of various intermediaries to monitor the process of application including ASBA applications till allotment is done. It supervises and ensures that security certificates are properly dispatched, refund orders completed and securities listed.

5.4.5 Underwriters

In case of unsubscribed issue, the merchant banker shall ensure that the underwriters shall honour their commitments within 60 days from the date of closure of the issue. The lead merchant banker shall furnish information to SEBI in respect of the underwriters who have failed to meet their underwriting obligations.

5.4.6 Post-issue Advertisements

The lead manager(s) shall ensure that an advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the registrar, date of credit of specified securities and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

CHAPTER 12

CREDIT RATING

LEARNING OUTCOMES

After going through the chapter student shall be able to understand

- Introduction
- Rating Services
- Objectives and types
- Uses of Credit Rating
- Credit Rating Process
- Credit Rating Methodology
- Camel Model of Credit Rating
- Rating Revisions
- Credit Rating Agencies in India and abroad
- Credit Rating Agencies and the US sub-prime crisis
- Limitations of Credit Rating Agencies

1. WHAT IS CREDIT RATING?

Credit Rating means an assessment made from credit-risk evaluation, translated into a current opinion as on a specific date on the quality of a specific debt security issued or on obligation undertaken by an enterprise in terms of the ability and willingness of the obligator to meet principal and interest payments on the rated debt instrument in a timely manner.

Thus Credit Rating is:

(1) An expression of opinion of a rating agency.

(2) The opinion is in regard to a debt instrument.

(3) The opinion is as on a specific date.

(4) The opinion is dependent on risk evaluation.

(5) The opinion depends on the probability of interest and principal obligations being met timely.

Such opinions are relevant to investors due to the increase in the number of issues and in the presence of newer financial products viz. asset backed securities and credit derivatives.

Credit Rating does not in any way linked with:

(1) Performance Evaluation of the rated entity unless called for.

(2) Investment Recommendation by the rating agency to invest or not in the instrument to be rated.

(3) Legal Compliance by the issuer-entity through audit.

(4) Opinion on the holding company, subsidiaries or associates of the issuer entity.

It should be noted that rating is a continuous process and as new information come, an earlier rating can be revised. While the rating is usually instrument specific, certain credit rating agencies like CARE, undertakes credit assessment of borrowers for use by banks and financial institutions.

2. RATING SERVICES

Following rating services are generally provided by the credit rating agencies. For this purpose, the example of CARE has been taken:

(i) Credit Rating

CARE undertakes credit rating of all types of debt instruments, both short-term and long-term.

Credit rating is basically a view expressed by the credit rater on the ability of an issuer of a debt (i.e. bonds and debentures) to make timely payments. So, credit rating is basically a relative ranking of the credit quality of debt based instruments. After the liberalization of the Indian economy in 1991, credit rating agencies have started playing a significant role in assessing the credit quality of debentures and bonds issued. The process of credit rating also reinforces the faith of investors in debt based instrument issued by corporates.

(ii) Information Services

The broad objective of the Information Service will be to make available information on any company, local body, industry or sector required by a business enterprise. Credit Rating Agencies through detailed analysis will enable the users of the service, like individual, mutual funds, investment companies, residents or non-residents, to make informed decisions regarding investments.

CARE, also prepares 'credit reports' on companies, for the benefit of banks and business enterprises. It will generally benefit the banks, insurance companies and other business enterprises by being cautious in granting loans or investing in the debt securities of a company.

(iii) Equity Research

Equity Research is another activity which credit rating companies pursue. CARE also does this. It generally covers detailed analysis of the major stock exchanges and identification of potential winners and losers. This includes among other things, judging them on the basis of industry, economy, market share, management capabilities, international competitiveness and other relevant factors.

3. OBJECTIVES OF CREDIT RATING

(i) Rating debt obligations of companies.

(ii) Guiding investors regarding the risk of investment in a debt security as to timely repayment of interest obligations and principle amount.

(iii) Creating awareness of the concept of credit rating amongst corporations, merchant bankers, brokers and regulatory authorities.

(iv) It helps in the creation of environment that facilitates debt rating.

(v) Inculcating a positive environment regarding investment in debt securities.

(vi) Helps in creating confidence in the minds of investors.

(vii) Enable the companies to be quality conscious regarding their securities and creating a positive pressure on them to fulfill their debt obligations.

4. TYPES OF CREDIT RATING

(a) Banks and Financial Institution ratings

(b) IPO Grading

(c) Structured Finance Ratings

(d) Sub-sovereign ratings

(e) Issuer Rating

(f) Insurance/ CPA ratings

(g) Corporate ratings

(h) Infrastructure ratings

(i) Corporate Governance ratings

(j) Fund credit Quality rating

5. USES OF CREDIT RATING

For users –

(i) Aids in investment decisions.

(ii) Helps in fulfilling regulatory obligations.

(iii) Provides analysts in Mutual Funds to use credit ratings as one of the valuable inputs to their independent evaluation system.

For issuers –

(i) Requirement of meeting regulatory obligations as per SEBI guidelines.

(ii) Recognition given by prospective investors of providing value to the ratings which helps them to raise debt / equity capital.

The rating process gives a viable market driven system which helps individuals to invest in financial instruments which are productive assets.

6. CREDIT RATING PROCESS

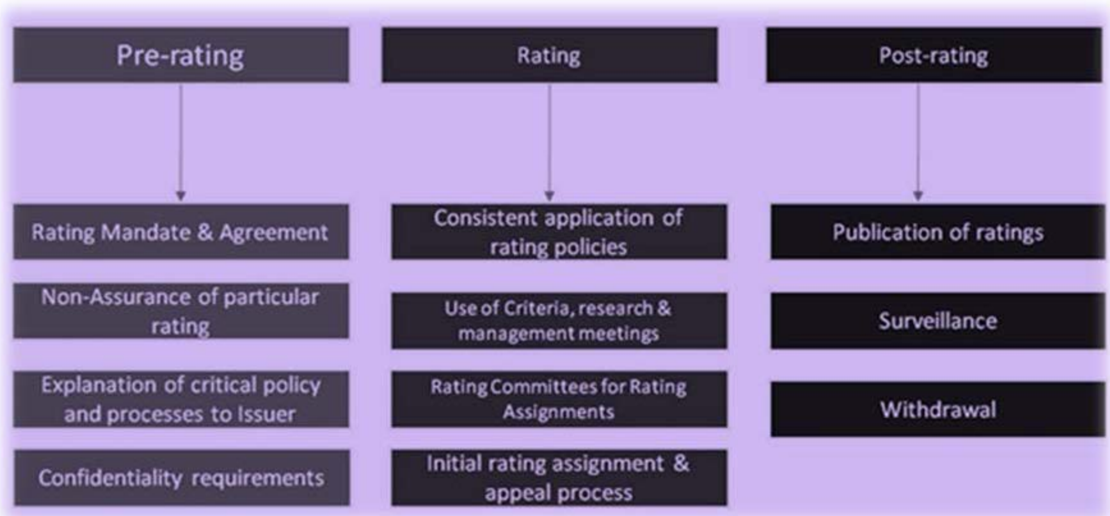
The default-risk assessment and quality rating assigned to an issue are primarily determined by three factors:

i) The issuer's ability to pay,

ii) The strength of the security owner's claim on the issue, and

iii) The economic significance of the industry and market place of the issuer.

The steps involved are:



a) **Request from issuer and analysis –** A company approaches a rating agency for rating a specific security. A team of analysts interact with the company's management and gathers necessary information. Areas covered are: historical performance, competitive position, business risk profile, business strategies, financial policies and short/long term outlook of performance. Also factors such as industry in which the issuer operates, its competitors and markets are taken into consideration.

b) **Rating Committee –** On the basis of information obtained and assessment made the team of analysts present a report to the Rating Committee. The issuer is not allowed to participate in this process as it is an internal evaluation of the rating agency. The nature of credit evaluation depends on the type of information provided by the issuer.

c) **Communication to management and appeal –** The Rating decision is communicated to the issuer and then supporting the rating is shared with the issuer. If the issuer disagrees, an opportunity of being heard is given to him. Issuers appealing against a rating decision are asked to submit relevant material information. The Rating Committee reviews the decision although such a review may not alter the rating. The issuer may reject a rating and the rating score need not be disclosed to the public.

d) **Pronouncement of the rating –** If the rating decision is accepted by the issuer, the rating agency makes a public announcement of it.

e) **Monitoring of the assigned rating –** The rating agencies monitor the on-going performance of the issuer and the economic environment in which it operates. All ratings are placed under constant watch. In cases where no change in rating is required, the rating agencies carry out an annual review with the issuer for updating of the information provided.

f) **Rating Watch –** Based on the constant scrutiny carried out by the agency it may place a rated instrument on Rating Watch. The rating may change for the better or for the worse. Rating Watch is followed by a full scale review for confirming or changing the original rating. If a corporate which has issued a 5 year 8% debenture merges with another corporate or acquires another corporate, it may lead to the listing of the specified.

g) **Rating Coverage –** Ratings are not limited to specific instruments. They also include public utilities; financial institutions; transport; infrastructure and energy projects; Special Purpose Vehicles; domestic subsidiaries of foreign entities. Structured ratings are given to MNCs based on guarantees or Letters of Comfort and Standby Letters of Credit issued by the banks. The rating agencies have also launched Corporate Governance Ratings with emphasis on quality of disclosure standards and the extent to which regulatory obligations have been complied with.

h) **Rating Scores –** A comparative summary of Rating Score used by four rating agencies in India is given below.

Sample of Rating Scores

Debentures	CRISIL	ICRA	CARE	FITCH
Highest Safety	AAA	LAAA	CARE AAA (L)	AAA (ind)
High Safety	AA	LAA	CARE AA (L)	AA (ind)
Adequate Safety	A	LA	CARE A (L)	A (ind)
Moderate Safety	BBB	LBBB	CARE BBB (L)	BBB (ind)
Inadequate Safety	BB	LBB	CARE BB (L)	BB (ind)
High Risk	B	LB	CARE B (L)	B (ind)
Substantial Risk	C	LC	CARE C (L)	C (ind)
Default	D	LD	CARE D (L)	D (ind)
Fixed Deposits				
Highest Safety	FAAA	MAAA	CARE AAA	TAAA
High Safety	FAA	MAA	CARE AA	TAA
Adequate Safety	FA	MA	CARE A	TA

7. CREDIT RATING METHODOLOGIES

The general methodology adopted by credit rating companies is to analyze various aspects of a business. They are briefly discussed as below:

(i) BUSINESS RISK

Business risk occurs when there is a possibility of a company earning lower profits than anticipated or incurring a loss. Business risk can be segregated into four categories - Strategic risk, compliance risk, operational risk and reputational risk. We have briefly discussed each one as follows:

(a) Strategic Risk: A successful business always needs a comprehensive and detailed business plan. Everyone knows that a successful business needs a comprehensive, well-thought-out business plan. But it's also a fact of life that, if things changes, even the best-laid plans can become outdated if it cannot keep pace with the latest trends. This is what is called as strategic risk. So, strategic risk is a risk in which a company's strategy becomes less effective and it struggles to achieve its goal. It could be due to technological changes, a new competitor entering the market, shifts in customer demand, increase in the costs of raw materials, or any number of other large-scale changes.

We can take the example of Kodak which was able to develop a digital camera by 1975. But, it considers this innovation as a threat to its core business model, and failed to develop it. However, it paid the price because when digital camera was ultimately discovered by other companies, it failed to develop it and left behind. Similar example can be given in case of Nokia when it failed to upgrade its technology to develop touch screen mobile phones. That delay enables Samsung to become a market leader in touch screen mobile phones.

However, a positive example can be given in the case of Xerox which invented photocopy machine. When laser printing was developed, Xerox was quick to lap up this opportunity and changes its business model to develop laser printing. So, it survived the strategic risk and escalated its profits further.

(b) Compliance Risk: Every business needs to comply with rules and regulations. For example with the advent of Companies Act, 2013, and continuous updating of SEBI guidelines, each business organization has to comply with plethora of rules, regulations and guidelines. Non compliance leads to penalties in the form of fine and imprisonment.

However, when a company ventures into a new business line or a new geographical area, the real problem then occurs. For example, a company pursuing cement business likely to venture into sugar business in a different state. But laws applicable to the sugar mills in that state are different. So, that poses a compliance risk. If the company fails to comply with laws related to a new area or industry or sector, it will pose a serious threat to its survival.

(c) Operational Risk: This type of risk relates to internal risk. It also relates to failure on the part of the company to cope with day to day operational problems. Operational risk relates to 'people' as well as 'process'. We will take an example to illustrate this. For example, an employee paying out ₹ 1,00,000 from the account of the company instead of ₹ 10,000.

This is a people as well as a process risk. An organization can employ another person to check the work of that person who has mistakenly paid ₹ 1,00,000 or it can install an electronic system that can flag off an unusual amount.

(d) Reputational Risk: Reputational impact mostly follows a decision under business risk. For example closing of project in a country on the ground of viability, (which GM has done in India) creates a bad reputation for the company. For example, in the above case, it is observed that employees are reacting negatively to the decision and started feeling insecure.

On the other hand, adding related products down the line adds customer confidence and boost investor's confidence. For example, several Indian banks have embarked on opening e-trading account. This has added to the reputation and market confidence.

(ii) FINANCIAL RISK

Financial Risk is referred to as the unexpected changes in financial conditions such as prices, exchange rate, Credit rating, and interest rate etc. Though political risk is not a financial risk in direct sense but same can be included as any unexpected political change in any foreign country may lead to country risk which may ultimately result in financial loss.

Accordingly, the Financial Risk can be broadly divided into following categories:

(a) Counter Party Risk

(b) Political Risk

(c) Interest Rate Risk

(d) Currency Risk

Now, let us discuss each of the above mentioned risks:

(a) Counter Party Risk: This risk occurs due to non-honoring of obligations by the counter party which can be failure to deliver the goods for the payment already made or vice-versa or repayment of borrowings and interest etc.

Thus, this risk also covers the credit risk i.e. default by the counter party.

(b) Political Risk: Generally this type of risk is faced by overseas investors, as the adverse action by the government of host country may lead to huge loses. This can be on any of the following forms:

- Confiscation or destruction of overseas properties.
- Rationing of remittance to home country.
- Restriction on conversion of local currency of host country into foreign currency.
- Restriction on borrowings.
- Invalidation of Patents
- Price control of products

(c) Interest Rate Risk: This risk occurs due to change in interest rate resulting in change in asset and liabilities. This risk is more important for banking companies as their balance sheet's items are more interest sensitive and their base of earning is spread between borrowing and lending rates.

As we know that the interest rates are of two types i.e. fixed and floating. The risk in both of these types is inherent. If any company has borrowed money at floating rate then with increase in floating rate, the liability under fixed rate shall remain the same. On the other hand, with falling floating rate, the liability of the company to pay interest under fixed rate shall comparatively be higher.

(d) Currency Risk: This risk mainly affects the organization dealing with foreign exchange as their cash flows changes with the movement in the currency exchange rates. This risk can affect the cash flow adversely or favorably. For example, if rupee depreciates vis-à-vis US$ receivables will stand to gain in comparision to the importer who has the liability to pay bill in US$. The best case we can quote, Infosys (Exporter) and Indian Oil Corporation Ltd. (Importer).

(iii) MANAGEMENT EVALUATION

In order to evaluate the management of a company, the best way is to see the company's Management discussion and analysis (MD&A) report which every listed company is compulsory required to provide. In case of unlisted companies also, the credit rating companies can influence the companies to include MD&A in their Annual Report.

Actually, MD&A is the section of a company's annual report in which management provides a summary of the previous year's operations and how the company performed financially. Management also gives an outline for the next year by highlighting future plans and some brief about the new projects to be launched by the company.

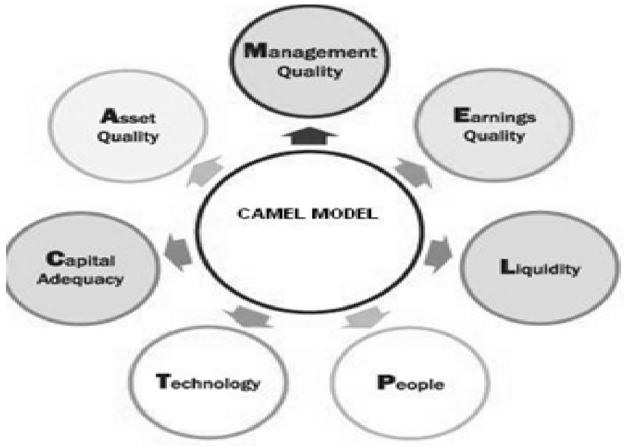
(iv) BUSINESS ENVIRONMENT ANALYSIS

A business environment analysis includes examining factors which influence from outside of a business. These business environment factors can range from new laws such as Companies Act, 2013; new trends i.e. the latest trends is to shop online; and new technology, for instance battery cars which in future can be charged on road itself without the even the need to stop the car.

Now, after considering the above mentioned environmental factors, the next step in the business environment analysis will be to determine as to how much impact they will have on the business. After that strategies will be developed to ward off any negative impact that has arisen.

8. CAMEL MODEL IN CREDIT RATING

CAMEL Stands for Capital, Assets, Management, Earnings and Liquidity. The CAMEL model adopted by the Rating Agencies deserves special attention; it focuses on the following aspects:



1) **Capital –** Composition of Retained Earnings and External Funds raised; Fixed dividend component for preference shares and fluctuating dividend component for equity shares and adequacy of long term funds adjusted to gearing levels; ability of issuer to raise further borrowings.

2) **Assets –** Revenue generating capacity of existing/proposed assets, fair values, technological/ physical obsolescence, linkage of asset values to turnover, consistency, appropriation of methods of depreciation and adequacy of charge to revenues. Size, ageing and recoverability of monetary assets viz receivables and its linkage with turnover.

3) **Management –** Extent of involvement of management personnel, team-work, authority, timeliness, effectiveness and appropriateness of decision making along with directing management to achieve corporate goals.

4) **Earnings –** Absolute levels, trends, stability, adaptability to cyclical fluctuations and ability of the entity to service existing and additional debts proposed.

5) **Liquidity –** Effectiveness of working capital management, corporate policies for stock and creditors, management and the ability of the corporate to meet their commitment in the short run.

These five aspects form the five core bases for estimating credit worthiness of an issuer which leads to the rating of an instrument. Rating agencies determine the pre-dominance of positive /negative aspects under each of these five categories and these are factored in for making the overall rating decision.

9. RATING REVISIONS

Credit Rating is an opinion expressed by a credit rating agency at a given point of time based on the information provided by the company and collected by credit rating agency. However, the information collected from the company at the time of giving credit rating to it is amenable to change. Therefore, revision of credit rating is required.

To protect the interest of investors, SEBI has mandated that every credit rating agency shall, during the lifetime of the securities rated by it, continuously monitor the rating of such securities and carry out periodic reviews of all published ratings.

Moreover, India Ratings & Research (A Fitch Group Company) continuously monitors the ratings assigned to a particular instrument. In case of any changes in the ratings so assigned, India Ratings discloses the same through press releases and on its websites.

For instance, the CRISIL has updated long term credit rating of Sterlite Technologies Limited to 'CRISIL AA-/Stable from CRISIL A+/Watch Developing' and also its short term credit rating have been upgraded to CRISIL A1+ from CRISIL A1/Watch Developing. Additionally, CRISIL has removed its rating on bank loan facilities and debt instruments of the company from 'Watch with Developing Implications' and it has also withdrawn its rating on 'bonds' at the Company's request, as there is no amount outstanding against the said instrument.

10. CREDIT RATING AGENCIES IN INDIA

Around 1990, Credit Rating Agencies started to be set up in India.

Among them the most important ones are:

1) **Credit Rating Information Services of India Ltd. (CRISIL) –** Launched in the pre-reforms era, CRISIL has grown in size and strength over the years to become one of the top five globally rated agencies. It has a tie up with Standard and Poor's (S & P) of USA holding 10% stake in CRISIL. It has also set up CRIS – RISC a subsidiary for providing information and related services over the internet and runs an online news and information service. CRISIL's record of ratings covers 1800 companies and over 3600 specific instruments.

2) **Investment Information and Credit Rating Agency (ICRA) –** It began its operations in 1991. Its major shareholders are leading financial institutions and banks. Moody's Investor Services through their Indian subsidiary, Moody's Investment Company India (P) Ltd. is the single largest shareholder. ICRA covers over 2500 instruments.

3) **Credit Analysis and Research Ltd. (CARE) –** It was established in 1993. UTI, IDBI and Canara Bank are the major promoters. CARE has over 2500 instruments under its belt and occupies a pivotal position as a rating entity.

4) **Fitch Ratings India (P) Ltd. –** The Fitch Group, an internationally recognized statistical rating agency has established its base in India through Fitch Rating India (P) Ltd. as a 100% subsidiary of the parent organization. Its credit rating apply to a variety of corporates / issues and is not limited to governments, structured financial arrangements and debt instruments.

All the four agencies as discussed are recognized by SEBI.

11. CREDIT RATING AGENCIES ABROAD

(i) Standard and Poor's (S & P) Ratings

S&P Global Ratings have been in the credit rating business for more than 150 years. They are the world's leading provider of credit ratings. Their credit ratings are important not only for the corporates but also for the government and the financial sector. Their credit rating is basically an expression of opinion about the credit quality of a company i.e. whether that company is able to meet its financial obligations in time or not. S & P is operating in about 28 countries.

(ii) Fitch Ratings

Fitch is among the top three credit rating agencies in the world. Fitch Ratings is headquartered in both New York and London. Fitch Ratings' long-term credit ratings are assigned on an alphabetic scale from 'AAA' to 'D'. It was first introduced in 1924 and later adopted and licensed by S&P. It is a global leader in financial information services with operations in more than 30 countries.

(iii) Moody's Ratings

Moody's is an important contributor in the global financial market providing credit rating services that helps in the building up of a transparent and integrated financial market. The Corporation, which reported revenue of $3.6 billion in 2016, employs approximately 10,700 people worldwide and maintains a presence in 36 countries.

12. CREDIT RATING AGENCIES AND THE US SUB-PRIME CRISIS

Credit rating agencies played a very important role at various stages in the subprime crisis. They have been highly criticized for understating the risk involved with new, complex securities that fueled the United States housing bubble, such as mortgage-backed securities (MBS) and collateralized debt obligations (CDO).

An estimated $3.2 trillion in loans were made to homeowners with bad credit and undocumented incomes (e.g., subprime or Alt-A mortgages) between 2002 and 2007. These mortgages could be bundled into MBS and CDO securities that received high ratings and therefore could be sold to global investors. Higher ratings were believed justified by various credit enhancements including over-collateralization (i.e., pledging collateral in excess of debt issued), credit default insurance, and equity investors willing to bear the first losses. The critics claim that the rating agencies were the party that performed the alchemy that converted the securities from F-rated to A-rated. The banks could not have done what they did without the complicity of the rating agencies." Without the AAA ratings, demand for these securities would have been considerably less. Bank write downs and losses on these investments totalling $523 billion as of September 2008.

The ratings of these securities were a lucrative business for the rating agencies, accounting for just under half of Moody's total ratings revenue in 2007. Through 2007, ratings companies enjoyed record revenue, profits and share prices. The rating companies earned as much as three times more for grading these complex products than corporate bonds, their traditional business. Rating agencies also competed with each other to rate particular MBS and CDO securities issued by investment banks, which critics argued contributed to lower rating standards.

13. LIMITATIONS OF CREDIT RATING

1) **Rating Changes –** Ratings given to instruments can change over a period of time. They have to be kept under rating watch. Downgrading of an instrument may not be timely enough to keep investors educated over such matters.

2) **Industry Specific rather than Company Specific –** Downgrades are linked to industry rather than company performance. Agencies give importance to macro aspects and not to micro ones and over-react to existing conditions which come from optimistic/pessimistic views arising out of up/down turns.

3) **Cost Benefit Analysis –** Rating being mandatory, it becomes a must for entities rather than carrying out Cost Benefit Analysis. Rating should be left optional and the corporate should be free to decide that in the event of self-rating, nothing has been left out.

4) **Conflict of Interest –** The rating agency collects fees from the entity it rates leading to a conflict of interest. Rating market being competitive there is a possibility of such conflict entering into the rating system.

5) **Corporate Governance Issues –** Special attention is paid to

   a) Rating agencies getting more of its revenues from a single service or group.

   b) Rating agencies enjoying a dominant market position engaging in aggressive competitive practices by refusing to rate a collateralized/securitized instrument or compelling an issuer to pay for services rendered.

   c) Greater transparency in the rating process viz. in the disclosure of assumptions leading to a specific public rating.

14. CONTEMPORARY ASPECTS IN CREDIT RATING

SEBI tells rating agencies to disclose probability of default for issuers they rate

According to the latest Sebi circular, rating companies, in consultation with the regulator, will now create a uniform probability of default benchmark for each rating category on their website, for one-year, two-year and three-year cumulative default rates, both for the short term and long term.

Sebi also tweaked the methodology to arrive at default rates. It will now be based on marginal default methodology. This would ensure that a three-year default rate is greater than the one-year rate.

Tracking the probability of default is a departure from earlier practices and is also a step towards aligning Indian rules with global standards. So far in India, credit decisions have been more or less based only on assigned ratings. Globally, however, credit decisions are based on two more criteria—**probability of default and tracking deviation of bond spreads**.

Probability of default describes the likelihood of a default over a particular period. It provides the likelihood that a borrower will be unable to meet its debt obligations and is typically used globally in credit analyses and risk management frameworks.

The rating agencies would also be assessed based on probability of default. For an AAA-rated paper, for instance, the probability of default for a 1-year and 2-year paper should be zero; for a three-year paper, a 1% default probability would be accepted.

For AA, it will be zero for a one-year paper; for a two-year paper, the acceptable deviation is 2%. It will be 3% for an A-rated paper.

In line with global standards, the regulator in November had asked rating agencies to track deviation in bond spreads. The idea behind the move was to provide more information to bond subscribers and reduce reliance on assigned ratings.

Sebi has also asked rating agencies to disclose all factors to which ratings are sensitive.

"This is critical for the end-users to understand the factors that would have the potential to impact the creditworthiness of the entity," Sebi said in the circular. *(Source: www.livemint.com)*

CHAPTER 13

TREASURY OPERATIONS

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- RAISING AND DEPLOYMENT OF FUNDS
- RISK MANAGEMENT

1. INTRODUCTION

Treasury Operations or management includes management of a company's investments with the objective of managing the firm's resources so that the firm's liquidity needs is fully met and also income owing to the investment is also optimized. The function of Treasury Management involves raising of resources both at home and overseas, investment in bonds and also trading activities in bonds and currencies. Treasury Management is more prominent in commercial and investment banks, wherein investment activities are managed as part of its statutory requirement and also for trading activities either for its own proprietary needs and merchant transactions i.e., transactions for its customer behalf.

The Corporate Sector Treasury Management is done mainly from the point of view of arranging resources for business need and its cash management, management for firms' receivable and payable in different currencies and also hedging of balance sheet financial items.

The Treasury Management function is more intensive in banking context as the function is undertaken for itself and also on behalf of its customer's requirement. Broadly, the Treasury Management function involves operating in the Financial Markets such as Wholesale Debt Market, Stock Exchanges and also Currencies Markets, which are financial markets with large numbers of market participants. The volumes of transactions in these domestic markets are in multiple of INR in Billions and also multiple of billions in USD for FX market. Hence, these markets are actively managed and monitored through regulators/regulatory mechanism.

Thus, the Treasury functions mostly comprise functioning in following markets:

- **Fixed Income or Money Market:** The fixed income or money market involves buying and selling interest/coupon bearing securities for investment functions or trading intention. The fixed income or money market consists of instruments such as Treasury Bills, Government Securities, Bonds issued by PSU companies and Debenture issued by private corporate. The market involves both primary and new issue market and also secondary market, where active trading of securities takes place.
- **Mutual Fund Market:** Nowadays Mutual Fund has also become one of the important source for deployment of fund. Since variety of schemes are available for investment, treasury managers can invest in these funds as per their requirements and risk profile.
- **Foreign Exchange Market:** "FX" Market that buys and sells currencies. The currency pairs, that are traded in Indian Forex Markets are USD/INR, EUR/USD, USD/JPY, EUR/SWF, JPY/INR, GBP/INR etc.
- **Equity market:** It is the place where equity shares are listed and traded in the stock exchanges.

1.2 ORGANIZATION OF TREASURY

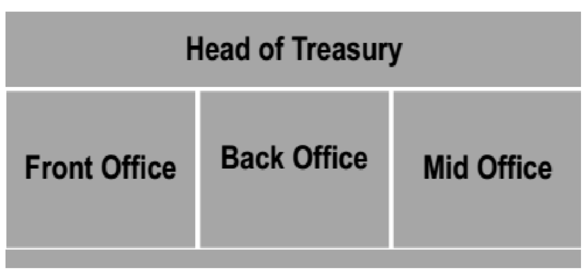
The organizational structure of Treasury Operation is based on the function and role of each of the offices within Treasury Division/verticals of any organization. The normal structure of Treasury Operation involves:

(i) Front Office

(ii) Back Office

(iii) Mid Office

The typical layout of an organizational structure of a Treasury is as below:



1.2.1 Front Office

The scope of Front Office involves buying, selling and trading of money market instruments, securities, Forex, equity, derivatives and precious metals. The front office set-up involves dealers/traders, chief dealer, In-charge of Front Office to execute trade on behalf of the banks/corporate. As trade transactions in a front office involve huge transactions of very high value, the conduct of front office traders is highly regulated as excessive position may lead to substantial loss to the organization.

The transactions of Front Office are done in a place called the 'Dealing Room'. The dealing room acts as the interface of the bank/corporate to the domestic and international financial markets, having the set up for dealers, financial information software, dealing terminals, high quality communication channels, Treasury application software, all integrated through IT platforms.

Thus, the critical components of any dealing room are human resources, i.e. dealers and traders and considering the risk involved in the trading or dealing activities, the dealers need to follow sound internal control and good conduct. These are generally:

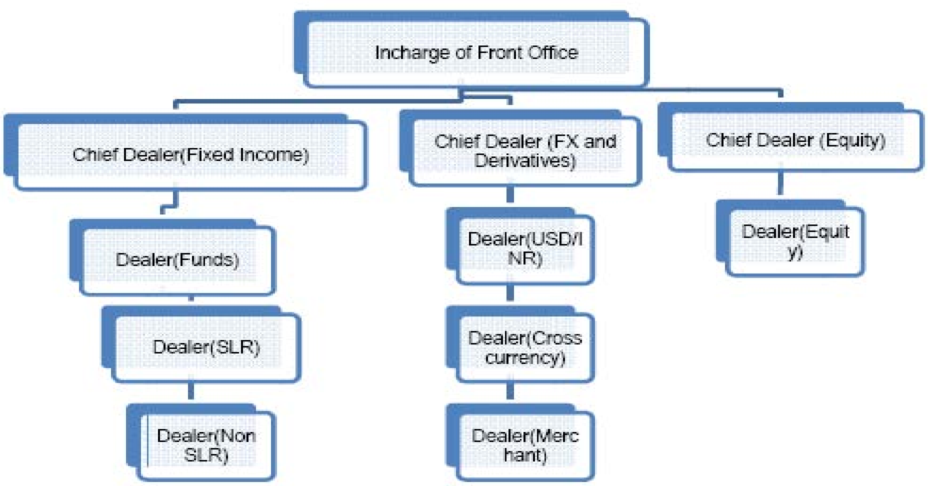
(a) **Code of Conduct**: In India dealers are asked to follow the code of conduct as approved in the organisation and firm. The RBI (for bank traders), FEDAI (for Foreign Exchange Dealers) and FIMMDA (for Money Market Dealers) have defined the code for traders in the trading room.

(b) **Adherence to Internal Limits**: Each organisation having a dealing room set has an investment policy, which defines the internal limits on exposure, position taking and many other limits. Dealers are required to adhere to the powers and limits as per these guidelines.

(c) **Dealing Hours**: Dealers should operate within the trading hours as defined by different markets.

(d) **Secrecy and Confidentiality**: Keys to the conduct of the dealers.

The person-in-charge of Front Office is generally a senior official of any organizational hierarchy who reports to In-Charge of Treasury. A typical structure of a front office is as below:



(SPECIMAN LAY OUT OF DEALING ROOM HIERARCAHY)

The dealing room structure of a typical bank is depicted as above. Depending upon the size of the portfolio, the number of dealers can be one or more. Similarly, depending upon the size of a portfolio, a dealer can also manage multiple portfolios. The segregation of structure is more from the point of view of type of portfolio.

1.2.2 Back Office

The back office is responsible for the delivery and settlement of all transactions concluded by the back office. The role of back office includes:

(a) Delivery and settlement and consequent accounting entries for all those transactions.

(b) Internal Control and checking over treasury dealings, confirmation and settlement activities and accounting thereof.

(c) Auxiliary functions of Treasury.

The key controls over market risk activities, and particularly over dealing room activities and function, exist in back office. It is important that clear segregation of duties and reporting lines are maintained between dealing room staff and back- office staff.

1.2.3 Mid-Office

Mid-Office functions as an independent risk assessment of the treasury functions of any bank or organization having Treasury Operation. The middle office is responsible for the critical functions of independent market risk monitoring, measurement, analysis and reporting for the management. An effective Middle office provides independent risk assessment which is critical to the firms' key function of controlling and managing the market risks in accordance with the mandate established by the Board of the organization. It is a highly-specialized function and must include trained and competent staffs. The methodology of analysis and reporting will vary from organization to organization depending upon degree of sophistication and exposure to market risk.

1.3 FUNCTION OF INTEGRATED TREASURY

The treasury management has been categorized from the point of Treasury functions of banks and that of corporate.

1.3.1 The Bank's treasury functions

(i) **Reserve Management:** The reserve management involves maintenance of Cash Reserve Ratio and Statutory Liquidity Ratio.

(ii) **Funds Management and Liquidity Management*:*** Funds are key to banking operation. The banking function involves large scale receipt and payment of cash. The funds management and liquidity management at Treasury involves not only arranging and managing aggregation of cash function at the branches of the bank, but also managing the CRR of the bank, thus would involve lending of money to interbank market participants/RBI and also borrowing of money from interbank participants/RBI.

(iii) **Investment and optimizing return on bank funds:** The treasury function involves investment of bank's fund not only the investment requirement in Government securities due to SLR requirement, but also investments over and above the SLR requirement in Government Securities, Non-SLR bonds and debentures, investment in equity shares, venture funds, mutual funds etc.

(iv) **Trading of investment products for trading profit:** Trading function is key to any Treasury functions. Banks are the most active trader in the markets with an eye on trading profit, which involves same day trading or holding the investment for a longer term and then off-loading the same in market with trading profit.

(v) **FX Treasury Operation:** The banks' treasury function also involves trading in Foreign Exchange markets both in the capacity of proprietary trading (trading on its own behalf) or on behalf of the corporate as part of merchant activities for a margin.

(vi) **Derivative Transactions:** The treasury function also involves derivative transactions to hedge its own book or on behalf of its clients or corporate.

1.3.2 Corporate Treasury Management functions

(i) **Cash management:** Cash management clearly forms part of the treasury's core functions. In addition to dealing with payment transactions; cash management also includes planning, account organisation, cash flow monitoring, managing bank accounts, electronic banking, pooling and netting as well as the functions of in-house bank.

(ii) **Liquidity planning and control:** Liquidity planning and control are closely linked to cash management.

(iii) **Management of interest, currency and commodity risks:** Large organizations (especially banks and financial institutions) have a separate Risk Management department which is responsible for the overall governance of all types of risks in the organisation. However, functions of Treasury revolves around management of interest and currency risks, commodity risks etc. This involves control of these risks, as well as the documentation of hedging transactions. Thus, while Risk Management department may be dealing with Market Risk, Treasury Department may be least concerned with the same.

(iv) **Procurement of finance and financial Investments:** The core duties of the treasury also comprise the procurement of finance and financial investments, and dealing with products such as term loan, working capital finance and factoring.

(v) **Corporate finance functions:** It comprise medium and long-term financing, particularly capital market instruments, group financing, credit, leasing, and negotiating with banks and financers for terms and condition of lending, hedging etc. Corporate finance is thus dealt with Treasury, which deals in finance of the firm with the sources of funding and the capital structure of the firm and the actions that managers take to increase the value of the firm to the shareholders, as well as the tools and analysis used to allocate financial resources.

(vi) **Contacts with banks and rating agencies:** The corporate treasury function also involves intensive contacts with banks and institution and rating agencies for corporate rating.

2. RAISING AND DEPLOYMENT OF FUNDS

2.1 RAISING OF FUNDS

A business entity requires funds to run the business. A business entity has no fund on its own. Every business entity runs on borrowed funds. A business entity borrows funds in the form of :

- Equity
- Debt

The strategy for borrowing in the form of debt and equity has been covered in the capital structure decisions.

Before we go into the details of different sources of funds, we have to first discuss the purpose of the fund. Actually, business borrows funds mainly for three purposes:

(a) Purchase /building up of current asset

(b) Purchase/building up of non-current asset

(c) Repayment of liability

Now we have to make some ground rules about how the financing of different assets would take place. These rules can change depending on the nature of borrower i.e. depending on the borrower's level of operation.

Purpose	Type of Borrowing	Borrower nature
Non Current Asset	Equity; Long Term Loan	Start up; Small and Medium SME; Mid corporat ; Large Corporate
Current Asset	Equity; Long term loa; Short term loan	Start up; Small and Medium SME
Non Current Asset	Short term loan	Large Corporate

Besides, the stage of development of the business and nature of business would also decide the type of borrowing. This is explained with the help of the following table:

Stage	Nature of business	Sources of Funds
Early stage	High Uncertainty	Equity; mainly angel funds
Early stage	High to Moderate Uncertainty	Equity, Venture Capital and Debt
Growth Stage	Moderate to Low Uncertainty	Debt, Venture Capital and Private Equity
Stable Stage	Low Uncertainty	Debt

Almost all major traditional sources of funds have been covered in the paper of Financial Management (Intermediate Level) and some other sources have been covered in the Paper of Strategic Financial Management (Final Level) and in the chapter Nos. 5 and 10 of this Study Material.

Hence, we shall discuss one another source of funding i.e.'Factoring'.

2.2 FACTORING

Since Domestic Factoring is covered under a separate chapter of Factoring, hence we shall discuss factoring in the context of International Transactions. In international transactions, factoring of receivable is also a very important corporate banking product. In most of the international trade transactions, besides the normal credit risks, it involves additional concepts of country and therefore sovereign risks come into play.

Sovereign risks in international business are usually divided into three broad categories:

- *Transaction Risk*: It is linked to a specific transaction that involves a specific amount within a specific time frame, such as an export sale on six month's draft terms;
- *Translation Risk:* It stems from the obligation of multinational companies to translate foreign currency assets and liabilities into the parent company's accounting currency regularly, a process that can give rise to book- keeping gains and losses.
- *Economic Risk*: In the broadest sense, it encompasses all changes in a company's international operating environment that generate, real economic gains or losses.

Export credit is quite distinct from it's domestic counterpart in several respects. The principal characteristics of export credit which distinguishes it from the domestic sales are as follows:

- Longer time scales for delivery, funds transfer and credit period;
- Extra time and distance require terms which provide a security for the risks perceived;
- The expectation of local credit terms for each market;
- Competition from other countries having different money costs and government policies;
- The use of international standard terminology.

This feeling of insecurity and risks involved in international transactions has, therefore, resulted in various methods of payment system, the most secure of these being the Advance Payment or Cash with Order (CWO). The other two prevalent methods of receiving payments are through the mechanism of Bills of Exchange and Documentary Credit. In both these methods, the banking system is the channel through which the transactions are normally carried out. Though advantageous to the sellers, secured to a certain extent, except the concept of clean bills of exchange (here shipping documents are not enclosed), usually in a competitive environment, debtors are not inclined to open letters of credit because of the cost and time involved. Further, the entire mechanism of operations through letter of credit is gradually going out of favour throughout the world primarily on account of what is known as Doctrine of Strict Compliance. The seriousness of the problems is evident from a survey conducted in United Kingdom which revealed that more than 50 percent of documents failed to comply with the terms of letter of credit in first presentation to the banks.

In view of the constraints of the existing systems, open account transactions are also coming into existence in larger numbers than in the past. Under this system, there is direct arrangement between the exporter and the importer to complete the deal including the payment by a predetermined future date, usually between 60 days and 90 days from the date of invoice. The goods and the shipping documents are sent directly to the importer enabling him to take delivery of goods. The essential features of open account transaction are listed as follows:

1. Complete confidence in the credit standing not only of the debtors but also of his country so that proceeds of the goods can be realized within the agreed period.
2. An efficient sales ledger administration often in multi currencies coupled with credit control mechanism involving sound knowledge of trade practices, law and knowledge of the importer's country.
3. Sufficient liquidity source to grant competitive credit terms to the importer.

In such a situation, export factoring can play a very important role not only in providing finance but also in providing a service package to exporters. Export factoring can broadly be defined as an agreement in which export receivables arising out of sale of goods/services are sold to the factor, as a result of which title to the goods/services represented by the said receivable passes on to the factor. Henceforth, the factor becomes responsible for all credit control, sales accounting and debt collection from the importers.

2.2.1 Advantages of International Factoring

The distinct advantages of a factoring transaction over other methods of finance/facilities provided to an exporter can be summarized as follows:

(i) Immediate finance up to a certain percentage (say 75-80 percent) of the eligible export receivable. This pre-payment facility is available without a letter of credit – simply on the strength of the invoice(s) representing the shipment of goods.

(ii) Credit checking of all the prospective debtors in importing countries, through own databases of the export factor or by taking assistance from his counterpart(s) in importing countries known as import factor or established credit rating agencies.

(iii) Maintenance of entire sales ledger of the exporter including undertaking asset management functions. Constant liaison is maintained with the debtors in importing countries and collections are effected in a diplomatic but efficient manner, ensuring faster payment and safeguarding of financial costs.

(iv) Accordingly, bad debt protection up to full extent (100 percent) on all approved sales to agreed debtors ensuring total predictability of cash flows.

(v) Undertaking cover operations to minimize potential losses arising from possible exchange rate fluctuations.

(vi) Efficient and fast communication system through letters, e-mail, and telephone or in person in the buyer's language and in line with the national business practices.

(vii) Consultancy services in areas relating to special conditions and regulations as applicable to the importing countries.

2.2.2 Two- Factor System

The most important form of factoring is two- factor system. The transaction is based on operation of two factoring companies in two different countries involving in all, four parties:

- Exporter;
- Importer;
- Export Factor in exporter's country; and
- Import factor in importer's country.

The basic mechanism of this arrangement works out as follows:

(i) The exporter approaches the export factor with relevant information which, inter alia, may include

a) Type of business,

b) Names and addresses of the debtors in various importing countries,

c) Annual expected export turnover to each country,

d) Number of invoices/credit notes per country,

e) Payment terms and

f) Line of credit required for each debtor.

(ii) Based on the information furnished, the export factor would contact his counterpart (import factor) in different countries to assess the creditworthiness of the various debtors.

(iii) The import factor makes a preliminary assessment as to his ability to give credit cover to the principal debtors.

(iv) Based on the positive response of the import factor, the factoring agreement is signed between the exporter and export factor.

(v) Goods are sent by the exporter to the importer along with the original invoice which includes an assignment clause stipulating that the payment must be made to the import factor.

Simultaneously, two copies of the invoice along with notifications of the debt are sent to the export factor. At this stage, prepayment up to an agreed percent (say 75-80 percent) of the invoice(s) is made to the exporter by the export factor.

(vi) A copy of the invoice is sent by the export factor to his counterpart that is the import factor. Henceforth, the responsibilities relating to book- keeping and collection of debts remain vested with the import factor.

(vii) Having collected the debts, the import factor remits the proceeds to his counterpart that is export factor. In case, payments are not received from any of the debtor(s) at the end of the previously agreed period on account of financial inability of the debtor concerned, the import factor has to pay the amount of the bill to his export counterpart from his own funds. However, this obligation will not apply in case of any dispute regarding quality, quantity, terms and conditions of supply etc. If any dispute arises, the same has to be settled between the parties concerned through the good offices of the factoring companies, otherwise legal action may have to be initiated by the import factor based on the instructions of the exporter/export factor.

(viii) On receipt of the proceeds of the debts realized, the retention held (say 15-20 percent) is released to the exporter. The entire factoring fee is debited to the exporter's account and the export factor remits the mutually agreed commission to his importing counterpart.

Thus, the export factor undertakes the exporter risk whereas the importer risk is taken care of by the import factor.

The main functions of the export factor relate to:

- Assessment of the financial strength of the exporter
- Prepayment to the exporter after proper documentation and regular audit and post sanction control
- Follow- up with the import factor
- Sharing of commission with the import factor

The import factor is primarily engaged in the areas of:

- Maintaining books of exporter in respect of sales to the debtors of his country
- Collection of debts from the importers and remitting proceeds of the same to the export factor
- Providing credit protection in case of financial inability on the part of any of the debtors.

The two factor systems are by all means the best mode of providing the most effective factoring facilities to a prospective exporter. However, the system is also fraught with certain basic disadvantages, i.e. delay in operations like credit decision, remittance of fund, etc., due to involvement of many parties.

2.3 DEPLOYMENT OF FUNDS

So far as the deployment of funds in commercial and corporate organisation is concerned, the same is governed by the various techniques such as capital budgeting, cost benefit analysis etc.

The deployment of funds is an important area in context of banks. Apart from lending the money in normal business, banks have to lend funds on priority basis for some Government sponsored schemes such as Prime Minister's Rozgar Yojana (PMRY), Swarna Jayanti Shahari Rozgar Yojana (SSRY) and Swarnajayanthi Grama Swarozgar Yojana (SGSY).

RBI fixes the target for this priority sector on time to time basis.

3. RISK MANAGEMENT IN TREASURY OPERATIONS

Effective risk management starts with identification and understanding of the various types of risks. It involves the establishment of risk limits, monitoring mechanisms, and the adoption of risk mitigating and other prudent practices.

3.1 RISK MANAGEMENT FRAMEWORK

Risk Management in Treasury is very critical to any organization as excessive risk taking and consequent losses can typically make the banks fail. The past experiences of Metallgesellschaft AG, Baring bank, plc, Workhardt Ltd, Allied Irish Bank, National Bank of Australia etc. are a few of the examples, wherein excessive risk taking, not monitoring dealers' position, non- adherence to risk limits such as cut losses, camouflaging losses have led to bankruptcy of these organization, which include corporate and banks, due to acts of a few individuals, endangering the interest of all other stake holders , who are engaged in the profitable core activities of the organisation.

The act of few individuals in excessive risk taking in treasury function of an organization has the potential to liquidate the organization/large businesses having otherwise strong business lines. Therefore, Treasury Risk Management has to be of the highest order and highest standard.

Consider Indian banking scenario. Banks here have large branch networks with thousands of branches and also thousands of employees engaged in banking activities. However, if the Treasury operation is not properly regulated, it can potentially lead to closure of the operation.

Thus, the risk management framework has to be sound and robust for Treasury. The risk management framework, includes a Prudent risk management system that helps in protecting an institution from excessive position/exposure taking leading to losses. Further, it should enhance the organizational ability to weather shocks. An effective risk management framework should comprise, but is not limited to, the following components:

(a) A comprehensive and well documented strategy for risk identification, measurement, aggregation and monitoring across the entire institution;

(b) Effective oversight by the Board of Directors and senior management;

(c) Implementation of proper controls on risk taking and prudent setting of risk tolerances by management;

(d) Clear communication of risk management policies and controls within the institution to promote awareness and ensure compliance;

(e) Strong information systems and adequate manpower resources for effective monitoring and timely reporting;

(f) Segregation of risk management functions from risk taking and operational units;

(g) Clear assignment of responsibilities and delegation of authority for various risk management functions; and

(h) Rigorous and prudent risk assessment and approval processes for new products, services, and procedures.

3.2 TYPES OF RISKS

Market participants should be aware of the various types of risks in treasury market transactions, including, but not limited to, the following:

a. Strategic risk – It means the risk of current or prospective impact on an institution's earnings, capital, reputation or standing arising from changes in the environment the institution operates in and from adverse strategic decisions, improper implementation of decisions, or lack of responsiveness to industry, economic or technological changes.

b. Market risk – Possible losses may arise from adverse movements in market rates or prices, such as foreign exchange rates, interest rates and option prices, etc.

(i) *Interest rate risk* – It refers to the risk to an institution's financial conditions resulting from adverse movements in interest rates.

(ii) *Foreign exchange risk* – It refers to the loss to an institution in foreign currency exposure due to volatility/movement in exchange rates on currency.

c. Credit risk – A counterparty to a transaction may default before the final settlement of the transaction's cash flow. Even if counterparty does not default, an increase in its perceived credit risk may result in a substantial increase of embedded credit default spreads, leading to substantial mark-to-market losses.

d. Settlement risk – It refers to the risk of loss due to the counterparty's failure to perform its obligation after an institution has fulfilled its obligation under a contract (through either an advance of funds or securities) at the settlement date. Herstatt Bank's case is leading example for Settlement Risk.

e. Liquidity risk – This is the risk that an institution may be unable to meet its obligations as they fall due. This may be caused by 'market liquidity risk' where an institution cannot easily unwind or offset specific exposures without lowering market prices significantly because of inadequate market depth or market disruptions. It may also be caused by 'funding liquidity risk' when an institution is unable to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting its daily operations or financial condition.

f. Operational risk – It refers to the risk of direct/indirect loss resulting from inadequate or failed internal processes, systems and controls, error made by staff, management failure, or from external events.

g. Legal risk – This is the risk relating to the legal and regulatory aspects of treasury market transactions. Unenforceable contracts, lawsuits or adverse judgments may have a negative impact on the operations, financial conditions and/or reputation of an institution.

h. Reputation risk – Negative publicity regarding an institution's products or business practices, whether true or not, may adversely affect its customer base and revenue, or lead to costly litigation.

The three major risks that banks and corporates are exposed to are:

(i) Market Risk

(ii) Credit Risk

(iii) Operational Risk

3.3 TECHNIQUES OF RISK MEASUREMENT

In relation to market risk, market participants generally adopt one or a combination of the following techniques for risk measurement:

(a) Nominal measure (also known as the "notional measure") – Under this measure, risk exposure is assessed by the nominal value of the financial instruments being held.

(b) Factor sensitivity measure – It estimates the sensitivity of an instrument or portfolio to changes in the market factors that affect their value (e.g. interest rates, exchange rates, and volatilities).

(c) Optionality measure - It estimates the sensitivity of an option's value to changes in the prices or volatility of the underlying instruments. Delta, vega, theta, and rho measure the expected change in an option's price for a unit change in the price, volatility, time to expiration and interest rates of the underlying instrument, respectively. Gamma measures the sensitivity of delta to a unit change in the price of the underlying instrument.

(d) Stress testing - It attempts to ascertain the possible value of positions or portfolios, capital adequacy and liquidity positions under exceptional conditions. For the test to yield reliable results, the assumptions used should mirror changes in market conditions as much as possible. Stress testing should be conducted on a firm-wise basis to highlight common exposures faced by different business units which could hit an institution at the same time.

(e) Scenario simulation – It assesses the probable market value of an instrument or portfolio under different market conditions and/or risk factors.

3.4 RISK MANAGEMENT LIMITS

An important part of risk control is to establish exposure limits to the various types of risks identified.

Primarily, the risk management is done by fixing limits, which act as tripwire for managing the risk originating from Treasury Operation.

Type of limits and Purposes

(i) Exposure Limits: Exposure limit is the limit set in for having exposure on a particular class of assets within financial market segments such as equity and debt depending upon the risk profile of these assets. The exposure can be industry specific, on capital market, on real estate, on portfolio etc. The exposure limits are fixed as a % of the portfolio/net worth/net owned fund etc.

(ii) Cut Loss Limits: Cut loss position allow the dealer to exit for a position (net purchase position is equity, debt, FX) at a pre-determined loss due to adverse movement of the rate on the position. For example, a purchase of Bank of Baroda share at @ Rs 1000/- share and if the cut loss is 10%, then if the price goes to the level of Rs 900/-, the dealer would compulsorily cut the position and book the loss of Rs 100/-. The cut loss position can be fixed

(a) Per Position/transaction

(b) Cumulative position dealer wise

(c) Cumulative fortnightly/quarterly loss for the portfolio

(iii) VaR Limits: Value at Risk is a measure of volatility and a risk measurement technique, which is defined as:

(a) Estimate of potential loss

(b) Of a given position

(c) Given holding period

(d) Given level of certainty.

For example, if the 7 days' value at Risk of Reliance stock is 7%, i.e., the maximum loss of 7% can happen to Reliance stock for a time horizon of 7 days at a confidence interval of 99.99%.Thus for risk management, VaR are generally fixed for portfolio, so that dealer/portfolio manager while building the portfolio, would not exceed the VaR limit for the portfolio.

(iv) FX limits: An open position arises, when a dealer buys and sells currency outright and does not square off by undertaking an offsetting transaction. When the dealer has bought more of a currency, it is said to be holding an overbought or long position. The risk of long position is the currency depreciating. Similarly, if the dealer sold more than what it bought of a currency, it is said to be holding an oversold or short position. The risk of short position is the currency appreciating.

The risk management in Forex, thus involves setting limits for the open positions and these are:

(a) *Day Light Limits*: Day Light position is the maximum position accumulated by dealer/dealers at any time during the day. For example, if a dealer has cumulative position of (-) 2 million, i.e over-sold 2 million, is the day light position for the dealer. Daylight limits the maximum intra-day position, on which the dealer can take position.

(b) *Overnight Limits*: Overnight limits the open position, which the dealer can carry overnight. Suppose, the dealer is expecting a further favourable movement of currency or expecting that the loss position, which he is holding would improve the next day, he can carry the (-) 2 position overnight i.e., overnight position. Overnight limit is the maximum overnight position, which a dealer can carry forward.

(c) *Individual Gap Limit*: Individual gap limit is the aggregate position of all positions i.e. spots and forwards for each of the currency.

(d) *Aggregate Gap Limits*: The sum of all IGL of each of the currencies, expressed in a single currency, i.e., USD is the aggregate Gap Limit.

(e) *VaR Limits*: is the limit fixed for keeping open position, which can be fixed currency-wise and also portfolio- wise.

(v) Counterparty limits*:* Counterparty limits are limits fixed for a counterparty, so that default risk of the counterparty is taken care of.

3.5 RISK MITIGATION

An institution should apply appropriate credit risk mitigating measures or credit enhancements to control its exposure to counterparties. The major common credit risk mitigating measures include netting, collateral and margining arrangements.

Written policies, procedures and controls should be put in place for the use of credit mitigation techniques. Management should also ensure that adequate systems are in place to manage such activities. This includes, among other things, regular revaluation of collateral and other mitigation instruments.

3.6 RISK MONITORING AND REPORTING

Effective risk monitoring requires the following practices:

(a) Physical and functional segregation of the trading room and the back office, including a segregation of reporting lines;

(b) Well-documented operating procedures to ensure, among other things;

 (i) *Proper deal capture* – transactions are properly captured such that risk positions can be compiled with in an accurate and timely manner for monitoring purpose;

(ii) *Timely reconciliation of differences* – differences between the front-end system, risk management system, credit system, back-end system and accounting system, etc., are identified in time and followed up; and

(iii) *Prompt rectification of limit excesses*;

(c) An effective and efficient reporting mechanism, which spells out, among other things, the circumstances under which exceptional reports have to be made to senior management;

(d) Independent verification of prices, rates and yield curves used for risk management and accounting purposes;

(e) Review of exceptional deviations of income from expected levels, having regard to the risk budget of the institution;

CHAPTER 14

RISK MANAGEMENT

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Preventive Controls
- Early Signals
- Credit Risk

1. INTRODUCTION

Market risk is inevitable part of capital market. Broadly, 'Market Risk' means changes in the market prices of underlying. In commercial business, the market risk may be a consequence but in capital market it forms organization's core business. Market risk can arise in different stages of services or different timing say during a hour, a day or a week. Generally, the primary concern in assessing the market risk is to assess it in absolute term or relative changes in comparison of any benchmark say interest rates etc.

As we have studied in the chapter of Portfolio Risk Management that unsystematic risk can be diversified but systematic risk cannot be diversified and systematic risk is the market related risk. Hence, market risk is closely associated with various financial products. This risk is also associated with subset of financial product called 'Derivative'.

Derivatives are generally used to hedge the market risk and even they are used to make speculative gains. However, though derivative has been proved to be a hedging instrument but in some cases it has proved to be disastrous to the existence of an organization.

2. TYPES OF MARKET RISKS

The market risk can be broken down into different classes:

2.1 Interest Rate Risk

This risk arises due to change in the yield curve. Since, interest dictates the returns and costs achieved in the business of lending and borrowing it affects not only current value of items of Balance Sheet of a financial institution but also the Off Balance Sheet items.

The various sources of interest rate risk are as follows:

a) Yield Curve Risk: - This risk arises from shift in the fixed income securities due to change in the interest rate. This lead to change in the value of fixed income securities. Sometimes this loss may be so vital that the existence of any organization can also be at stake.

b) Basis Risk: - Also called spread risk. This risk arises due to possible change in spreads. In the context of fixed income securities this risk arises due to change in relationship between interest rates based on different benchmarks. For instance, a bank has lent money on PLR basis which is currently 10% and borrowed money on Repo basis which is 7%. Thus, it may be possible that due to change in interest rate of any basis, this gap may be skewed.

c) Repricing Risk: - This risk arises on reset date, and mainly affects the fixed income securities which are due for maturities or whose rates are to be reset at some time in near future.

d) Optionality Risk: - This risk arises due to embedded optionality, feature in a financial product which gives either party (lender or borrower) an option to call or repay the money lent/borrowed.

This option is normally exercised in case of change of interest rate to which the borrowed/lent amount is linked. Suppose, current floating interest is 8% at which a person deposit money with bank for a period of 24 years. If after 6 months, interest rate goes upto 9%, then if depositor has option to claim refund before the due date, then he will, most likely, claim refund of fixed deposit so that he can reinvest the money at a better rate.

This can also be possible from banks point of view. If the bank has the option to refund money and the interest rate goes down, then it can refund money already borrowed at higher rate and again borrow money at lower rate.

2.2 Foreign Exchange Risk

As discussed in the Paper of Strategic Financial Management, this arises on account of change in the price of foreign currency. Although it does not affect all financial institutions but mainly affects the organization involved in trading foreign exchange i.e. Buying and Selling forex or Institutions whose assets and liabilities are denominated in foreign exchange.

2.3 Commodity Risk

This risk mainly arises due to change in price of commodities, commodity prices index etc. This risk mainly affects those financial institutions whose main parties are supplier, consumers, and traders of such commodities. A hedge fund which has invested a huge amount in an oil company's share will be adversely affected by falling oil prices.

2.4 Equity Risk

This risk normally occurs when there is a fall in equity indices or most of the equity shares. This kind of risk normally results from any unprecedented event, say, sovereign default etc. In case if the Government of any country defaults in its debt repayment then its equity market is likely to be adversely affected.

3. EARLY SIGNALS

Effective risk management starts with identification and understanding of the various types of risks. It involves the establishment of risk limits, monitoring mechanisms, and the adoption of risk mitigating and other prudent practices.

To test whether a firm is facing market risk or not, there are some signals which may indicate that a firm is facing the same risk.

a) **Applying Wrong Models: -** It might be possible that the models used to assess the risk are not adequately tested and may not be in a position to perceive a big or rare or unforeseen events contributing to huge losses.

b) **Weak Internal Control: -** A Company may not have adequate internal control due to which it may be more exposed to market as speculative action by a market participant may be left unchecked.

c) **Speculative Aptitude: -** Treasury departments in companies involved in non-financial business are meant for hedging the risk. However, it might be possible that they may be instructed to generate revenue and becomes profit centre.

d) **Non – Core Business:-** As mentioned above, a company may be involved in non-core business activities such as making large profit from the sale and purchase of foreign exchange, which may not be questioned by the management nor any limits were set for the person involved in treasury dealings.

   In such a situation, it might be possible that company may incur a huge loss on account of market risk.

e) **Inexperience:-** In some cases, it has been observed that a company may have exposure to those instruments or financial products for which it has no or very little experience. This type of exposure is normally undertaken to earn huge profit in short span of time.

f) **Sovereign Default: -** Sovereign debt crisis is one of the major signal of market risk as it will urge the investors to shift to more secure financial instruments. Further, sovereign debt crisis can also lead to loss of confidence in other type of financial instruments.

g) **Style Drift:-** In some cases, it has been observed that to cover the loss some manager may divert fund to more speculative transaction and, thus, pushing the company to severe market risk.

h) **Superstar:-** Sometime one person may be titled as superstar to which even management may be reluctant to question about his/her actions because of their his/her perceived ability to generate huge profits. In such a situation, it might be possible that there may be huge or unanticipated losses because these so called superstars may cross their limits.

i) **Inadequate Supervision: -** Inadequate supervision may be another strong signal that highlight the company's exposure to market risk.

4. CREDIT RISK

Credit is the basis of business though it is difficult to define but it can be termed as amount of money that will be paid later in exchange of some goods or services received earlier.

Since, it involves a commitment to pay in future and future is uncertain, the risk is obvious. Hence, credit risk can be defined as refusal or inability of credit customer to pay the owed sum partially or in full or in time.

Credit Risk is also known as counterparty risk.

While in non-banking businesses, the credit risk is related to promised payment for goods and services supplied, in the context of banking business, it means failure or refusal to refund the loan amount by the borrower in full or partially in time.

4.1 Two Way Risk

The definition of credit risk can also be viewed from a different angle i.e. receiver of goods or borrower in case of banking. This risk lies in not supplying the committed supply of goods by the seller leading to production halt or other results for the buyer.

Similarly in banking business, the borrower faces the risk of withdrawing of lending facilities by the bank.

4.2 Risk – Return Trade Off

As discussed earlier, credit is the basis of business and accordingly, decision to give credit to be taken there should be a tradeoff between the risk and return (reward) for the supplier or lender. In case of banking business, risk is greater when larger amount of credit is granted or when credit is granted for longer periods.

The optimal credit decision would maximize return. The trade-off between risk and return in the context of Credit Risk calls for following decisions:

i) How much Credit Risk should be accepted in return for increase in sale or increase in business in case of banking?

ii) How much compensation should be added while pricing the product?

iii) Placing of Credit Cap or limit for each customer.

iv) Acceptance or rejection of customer's request.

4.3 Credit Risk in Capital Market

Credit Risk analysis from Bank's point of view will be an umbrella covering credit risk of other financial institutions. A bank acts as intermediate between provider of funds and seeker of funds. Bank accepts deposits from one group and provides funds to other group. Since bank grants credit it accepts the risk on regular basis. Hence, banks evaluate their experience and incorporate lessons from failure in a routine manner.

Banks caters both segments wholesale as well as retail. The main distinction between these two segments is complexities of financial products involved. For example, in case of retail segment, the banking product may generally range from credit card to housing loans, while in case of whole sale segment, there are 'n' number of financial products. Main sources of seeker of bank's fund are corporates, ranging from small cap to large cap.

4.3.1 Categories of Credit Risk

Broadly, credit risk can be divided into following categories:

(i) **Default Risk –** This risk means missing a payment obligation (of principal or interest or both). Default Risk can be measured by probability of default. It depends on credit worthiness of a borrower which in turn depends upon various factors such as management of organization, size of business, strength and reputation of promoters etc.

(ii) **Exposure Risk –** This implies the uncertainty associated with future level or amount of risk. In other words, this risk is mainly associated with unexpected action of other party, say, prepayment of loan before due date or request for refund of deposit before due date.

In some cases, say for amortized credit, such risks does not exist as period of receipt is known with greater certainty. Due to uncertainty, generally off balance sheet items create such risks. However, in such cases, the exposure is not associated with client's behavior rather behaviors of market which keeps on changing constantly. In case, if value of derivative position turns out to be positive, there is a credit risk as it will lose money, if other party defaults. To overcome such risk normally derivative instrument are used.

(iii) **Recovery Risk –** This risk is related to recoveries in the event of default, which in turn depends upon various factors such as quality of guarantee provided by borrower, and other surrounding circumstances. This risk can be minimized through Collateral and Third Party Guarantee. However, existence of these two risk management tool also carries risk.

(a) **Collateral Risk:** Although collateral reduces the credit risk but it happens only if collateral is sold at a significant value. The quickness in realization of collateral depends upon its nature and prevailing market conditions. In normal course, fixed asset collateral normally carries low realizable value than cash collateral. However, if in buoyant market say in case of a property even a fixed asset in the form of a house property carries a higher value. With the use of collateral, the credit risk becomes twofold:

(i) Uncertainty related to access it and disposing encumbrances which may be legal in some cases.

(ii) Uncertainty related to the value realizable from the collateral which may be subject to various factors. To some extent the 2008 crisis was due to overvaluation of collateral against which borrowers were granted hefty loan, and at the time of realization, the collateral value was very less.

(b) **Third Party Guarantee Risk:** This collateral is a kind of simple transfer of risk on Guarantor, and in case guarantor defaults, then risk again comes back to lender.

4.3.2 Measurement of Credit Risk in Banking Transactions

To measure random loss, following formula can be used:

D X A X (1 – r)

D = Default %

A = Amount of Exposure

R = Recovery Rate %

This default % can also be computed through probability.

4.3.3 Factors Affecting the Credit Risk

The factors affecting the credit risk of a bank can be divided into following two categories:

(i) **Internal Factors:** These factors are internal to the bank, some of these are as follows:

(a) Concentration of credit in particular geographical locations or business segments.

(b) Excessive lending to particular industry is subject to cyclical fluctuations.

(c) Ignoring the purpose for which loan was sought by the customer.

(d) Poor Quality or Liberal Credit Appraisal while granting the loan.

(e) Absence of efficient recovery mechanism.

(ii) External Factors: These factors are external to the bank and beyond its control. These factors not only impact the profitability of borrower but also affect their repayment capability. Some of such external factors are as follows:

(a) Fluctuation in Exchange Rate.

(b) Change in Govt. Policies.

(c) Fluctuation in Interest Rates.

(d) Change in Political Environment of the country.

(e) In case of Foreign project change in Country Risk profile.

4.3.4 Credit Risk Management in Banks

In order to implement appropriate Credit Risk Management system in bank, Reserve Bank of India (RBI) expects every bank to take specific measures. The broad disclosures on the following to be made:

1. Policy Framework
2. Credit Rating Framework
3. Credit Risk Models
4. Portfolio Management and Risk Limits
5. Managing Credit Risk in Inter-bank Exposure
6. Credit Risk in Off-Balance Sheet Exposure
7. Country Risk
8. Loan Review Mechanism/ Credit Audit
9. RAROC Pricing/ Economic Profit
10. New Capital Accord: Implications for Credit Risk Management

Now let us discuss some of these guidelines briefly:

1. **Policy Framework:** Based on broad management framework bank should have credit risk measurement and monitoring procedures.

2. **Credit Rating Framework:** Such a rating framework is the basic module for developing a Credit Risk Management System and all advanced models/approaches are based on this structure.

3. **Credit Risk Models:** A credit risk Model seeks to determine (quantify) the risk that the promised cash flow will not be forthcoming. Some of the following techniques can be used:

   (a) Econometric Indicators

(b) Neural Network

(c) Optimisation Model

(d) Rule based or Expert System

(e) Hybrid System

4. **Portfolio Management and Risk Limits:** The need of credit portfolio management emanates from the necessity to optimize the benefits associated with diversification and reduce the potential adverse impact of concentration of exposure to particular borrower and sector or industry.

5. **Managing Credit Risk in Interbank Exposure:** During the course of its business with other banks, a bank may be exposed to credit risk and therefore it is important to determine proper evaluation of credit risk.

   The key parameters to be evaluated for any bank are as follows:

   a. Capital Adequacy

   b. Asset Quality

   c. Liquidity

   d. Profitability

6. **Credit Risk in Off Balance Sheet Exposure:** For reducing Credit Risk on account of such credit, banks can take many steps.

7. **Country Risk:** In the context of banking business, this risk arises on account of cross border lending and investment. Country risk may comprise the following:

   - **Transfer Risk –** Due to restriction on external transfer of funds.
   - **Sovereign Risk –** Sovereign entities may claim immunity in case of default.
   - **Non Sovereign Risk –** It is also called political risk or expropriation risk. This risk implies taking over control by the government of a country.
   - **Currency Risk –** Possibility of change in the exchange rate between the currencies of the countries.
   - **Macroeconomic and Structural Fragility Risk –** This risk arises on account of poorly developed and weak enforcement in court of law.

For more details, students may refer RBI Guidelines on Risk Management by Banks.

CHAPTER 15

CREDIT DERIVATIVES

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Credit Default Swaps
- Collateralized Debt Obligations (CDOs)
- Pricing of Credit Derivative Instruments

'Credit Derivatives' is the sum of two words i.e. Credit + Derivatives. As we know that derivative implies value deriving from an underlying, and this underlying can be anything as we have discussed earlier i.e. stock, share, currency, interest etc.

Initially started in 1996 due to the need of the banking institutions to hedge their exposure of lending portfolios, today it is one of the most structured financial products.

Plainly speaking, the financial products are subject to following two types of risks:

(a) *Market Risk*: Due to adverse movement of the stock market, interest rates and foreign exchange rates.

(b) *Credit Risk*: Also called counter party or default risk, this risk involves non-fulfillment of obligation by the counter party.

While, financial derivatives can be used to hedge the market risk, credit derivatives emerged out to mitigate the credit risk. Accordingly, the credit derivative is a mechanism whereby the risk is transferred from the risk averse investor to those who wish to assume the risk.

Although there are number of credit derivative products but in this chapter, we shall discuss two types of credit Derivatives 'Collaterised Debt Obligation' and 'Credit Default Swap'.

1. COLLATERALIZED DEBT OBLIGATIONS (CDOs)

Collateralized Debt Obligations (CDOs) are an advancement of securitization discussed in the paper of Strategic Financial Management. While in securitization, the securities issued by SPV are backed by the loans and receivables, the CDOs are backed by pool of bonds, asset backed securities, REITs, and other CDOs. Accordingly, it covers both Collateralized Bond Obligations (CBOs) and Collateralized Loan Obligations (CLOs).

1.1 Types of CDOs

The various types of CDOs are as follows:

(a) Cash Flow Collateralized Debt Obligations (Cash CDOs): Cash CDO is a type of CDO which is backed by cash market debt or securities which normally have low risk weight. This structure mainly relies on the collateral's risk weight and collateral's ability to generate sufficient cash to pay off the securities issued by SPV.

(b) Synthetic Collateralized Debt Obligations: It is similar to Cash Flow CDOs but with the difference that instead of transferring of ownerships of collateral to SPV (a separate legal entity), synthetic CDOs are structured in such a manner that credit risk is transferred by the originator without actual transfer of assets.

Normally the structure resembles the hedge funds where in the value of portfolio of CDO is dependent upon the value of collateralized instruments and market value of CDOs depends on the portfolio manager's ability to generate adequate cash and meeting the cash flow obligations (principal and interest) in timely manner.

While in cash CDO, the collateral assets are moved away from Balance Sheet, in synthetic CDO there is no actual transfer of assets instead economic effect is transferred.

This effect of transferring economic risk is achieved by creating provision for Credit Default Swap (CDS) or by issue of Credit Linked Notes (CLN), a form of liability.

Accordingly, this structure is mainly used to hedge the risk rather than balance sheet funding. Further, for banks, this structure also allows the customer's relations to be unaffected. This was started mainly by banks who want to hedge the credit risk but not interested in taking administrative burden of sale of assets through securitization.

Technically, speaking synthetic CDO obtain regulatory capital relief benefits vis-à-vis cash CDOs. Further, they are more popular in European market due to the reason of less legal documentation requirements. Synthetic CDOs can also be categorized as follows:

(a) Unfunded: - It will be comprised of CDs only.

(b) Fully Funded: - It will be through issue of Credit Linked Notes (CLN).

(c) Partially Funded: - It will be partially through issue of CLN and partially through CDs.

(c) Arbitrage CDOs: Basically, in Arbitrage CDOs, the issuer captures the spread between the return realized collateral underlying the CDO and cost of borrowing to purchase these collaterals. In addition to this, the issuer also collects the fee for the management of CDOs. This arbitrage arises due to acquisition of relatively high yielding securities with large spread from open market.

1.2 Risk involved in CDOs

CDOs are structured products and just like other financial products are also subject to various types of Risk.

The main types of risk associated with investment in CDOs are as follows:

(1) **Default Risk: -** Also called 'credit risk', it emanates from the default of underlying party to the instruments. The prime sufferers of these types of risks are equity or junior tranche in the waterfall.

(2) **Interest Rate Risk: -** Also called Basis risk and mainly arises due to different basis of interest rates. For example, asset may be based on floating interest rate but the liability may be based on fixed interest rates. Though this type of risk is quite difficult to manage fully but commonly used techniques such as swaps, caps, floors, collars etc. can be used to mitigate the interest rate risk.

(3) **Liquidity Risk: -** Another major type of risk by which CDOs are affected is liquidity risks as there may be mismatch in coupon receipts and payments.

(4) **Prepayment Risk: -** This risk results from unscheduled or unexpected repayment of principal amount underlying the security. Generally, this risk arises in case assets are subject to fixed rate of interest and the debtors have a call option. Since, in case of falling interest rates they may pay back the money.

(5) **Reinvestment Risk: -** This risk is generic in nature as the CDO manager may not find adequate opportunity to reinvest the proceeds when allowed for substitutions.

(6) **Foreign Exchange Risk: -** Sometimes CDOs are comprised of debts and loans from countries other than the country of issue. In such a case, in addition to above mentioned risks, CDOs are also subject to the foreign exchange rate risk as discussed in the paper Strategic Financial Management.

2. CREDIT DEFAULT SWAP (CDS)

It is a combination of following 3 words:

Credit : Loan given

Default : Non payment

Swap : Exchange of Liability or Risk

Accordingly, CDS can be defined as an insurance (not in stricter sense) against the risk of default on a debt which may be debentures, bonds etc.

Under this arrangement, one party (called buyer) needing protection against the default pays a periodic premium to another party (called seller), who in turn assumes the default risk. Hence, in case default takes place then there will be settlement and in case no default takes place no cash flow will accrue to the buyer alike option contract and agreement is terminated. Although it resembles the options but since element of choice is not there it more resembles the swap arrangements.

Amount of premium mainly depends on the price of underlying and especially when the credit risk is more.

2.1 Main Features of CDS

The main features of CDS are as follows:

1. CDS is a non-standardized private contract between the buyer and seller. Therefore, it is covered in the category of Forward Contracts.
2. They are normally not traded on any exchange and hence remains free from the regulations of Governing Body.
3. The International Swap and Derivative Association (ISAD) publishes the guidelines and general rules used normally to carry out CDS contracts.
4. CDS can be purchased from third party to protect itself from default of borrowers.
5. Similarly, an individual investor who is buying bonds from a company can purchase CDS to protect his investment from insolvency of that company. Thus, this increases the level of confidence of investor in Bonds purchased.
6. The cost or premium of CDS has a positive relationship with risk attached with loans. Therefore, higher the risk attached to Bonds or loans, higher will be premium or cost of CDS.
7. If an investor buys a CDS without being exposed to credit risk of the underlying bond issuer, it is called “naked CDS”.

2.2 Uses of Credit Default Swap

Following are the main purposes for which CDS can be used.

(a) **Hedging-** Main purpose of using CDS is to neutralize or reduce a risk to which CDS is exposed to. Thus, by buying CDS, risk can be passed on to CDS seller or writer.

(b) **Arbitrage-** It involves buying a CDS and entering into an asset swap. For example, a fixed coupon payment of a bond is swapped against a floating interest stream.

(c) **Speculation-** CDS can also be used to make profit by exploiting price changes. For example, a CDS writer assumed risk of default, will gain from contract if credit risk does not materialize during the tenure of contract or if compensation received exceeds potential payout.

2.3 Parties to CDS

In a CDS at least three parties are involved which are as follows:

i. **The initial borrowers-** It is also called a 'reference entity', i.e. the entities which are owing a loan or bond obligations.

ii. **Buyer-** It is also called 'investor' i.e. the buyer of protection. The buyer will make regular payment to the seller for the protection from default or credit event of reference entity.

iii. **Seller-** It is also called 'writer' of the CDS and makes payment to buyer in the event of credit event of reference entity. It receives a regular pay off from the buyer of CDS.

Example-
Suppose BB Corp. buys CDS from SS Bank for the Bonds amounting $ 10 million of Danger Corp. In such a case, the BB Corp. will become the buyer, SS Bank becomes seller and Danger Corp. becomes the reference entity. BB Corp. will make regular payment to SS Bank of the premium and if Danger Corp. defaults on its debts, the BB Corp. will receive one time payment and CDS contract is terminated.

2.4 Settlement of CDS

Broadly, following are two main ways of settlement of CDS:

(i) **Physical Settlement –** This is the traditional method of settlement. It involves the delivery of Bonds or debts of the reference entity by the buyer to the seller and seller pays the buyer the par value.

For example, as mentioned above suppose Danger Corp. defaults then SS Bank will pay $ 10 Million to BB Corp. and BB Corp will deliver $10 Million face value of Bonds to SS Bank.

(ii) **Cash Settlement-** Under this arrangement seller pays the buyer the difference between par value and the market price of a debt (whatever may be the market value) of the reference entity. Continuing the above example suppose, the market value of Bonds is 30%, as market is of belief that bond holder will receive 30% of the money owed in case company goes into liquidation. Thus, the SS Bank shall pay BB Corp. $ 10 Million - $3 million (100% - 30%) = $ 7 Million.

To make Cash settlement even more transparent, the credit event auction was developed. Credit event auction set a price for all market participants that choose to cash settlement.

2.5 CDS in India

In India, RBI has come out with guidelines on CDS in corporate bonds in 2011 which was revised in 2013.

As per the guidelines, CDS players have been divided into following two categories:

(a) **Market Makers: -** These are comprised of commercial banks, primary dealers (PDS) and non-banking financial companies (NBFCs). They can buy or sell without any underlying position in the bond i.e. Naked CDS.

(b) **Users: -** These are comprised of mutual funds (MFs), Insurance Companies, Housing Finance Companies, Provident Funds, Listed Companies and Foreign Institutional Investors (FIIs). They can use CDS only as a hedge tool to offset the risk of an underlying position, and are not allowed to sell CDS other than to exit the existing long positions.

Note: For detailed guidelines, students can visit RBI's website.

3. PRICING OF CREDIT DERIVATIVE INSTRUMENTS

Broadly following are two theories for pricing CDS:

(1) *Probability Model*- This model is based on the present value of a series of cash flows weighted by their respective probability of non-default. This model is based on following four inputs.

- (a) Issue Premium
- (b) Recovery Rate
- (c) Credit Curve for reference entity and
- (d) Inter banking offering rates e.g. LIBOR, MIBOR etc.

(2) *No Arbitrage Model*- This approach was advocated by Duffie as well as Hull-White. This model is based on following assumptions:

- (a) There is zero cost of unwinding the fixed leg of the swap on default.
- (b) There is no risk free arbitrage.

While Duffie used LIBOR as the risk-free rate, Hull and White used US Treasuries as the risk free rate. As per this model, price is derived by calculating the asset swap spread of a bond.

CHAPTER 16

LEASING

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Meaning, types, advantages and disadvantages of Leasing
- Financial evaluation of lease proposal from perspective of Lessee and Lessor
- Break Even Lease Rental (BELR) from Lessee's and Lessor's point of view
- Cross Border Leasing
- Regulatory Aspects of Leasing

1. LEASING

1.1 What is lease

Lease can be defined as a right to use equipment or capital goods on payment of periodical amount. This may broadly be equated to an instalment credit being extended to the person using the asset by the owner of capital goods with small variation.

1.2 Parties to a Lease Agreement

There are two principal parties to any lease transaction as under:

Lessor : Who is actual owner of equipment permitting use to the other party on payment of periodical amount.

Lessee : Who acquires the right to use the equipment on payment of periodical amount.

1.3 Lease vis-à-vis Hire Purchase

Hire-purchase transaction is also almost similar to a lease transaction with the basic difference that the person using the asset on hire-purchase basis is the owner of the asset and full title is transferred to him after he has paid the agreed installments. The asset will be shown in his balance sheet and he can claim depreciation and other allowances on the asset for computation of tax during the currency of hire-purchase agreement and thereafter.

In a lease transaction, however, the ownership of the equipment always vests with the lessor and lessee only gets the right to use the asset. Depreciation and other allowances on the asset will be claimed by the lessor and the asset will also be shown in the balance sheet of the lessor. The lease money paid by the lessee can be charged to his Profit and Loss Account. However, the asset as such will not appear in the balance sheet of the lessee. Such asset for the lessee is, therefore, called off the balance sheet asset.

2. TYPES OF LEASING

A lease transaction has many variants relating to the type and nature of leased equipment, amortisation period, residual value of equipment, period of leasing, option for termination of lease etc. Various types of leasing transactions are, therefore, operating in the market on the basis of these variants. The different leasing options may however, be grouped in following categories as under:

(a) Operating Lease: In this type of lease transaction, the primary lease period is short and the lessor would not be able to realize the full cost of the equipment and other incidental charges thereon during the initial lease period. Besides the cost of machinery, the lessor also bears insurance, maintenance and repair costs etc. The lessee acquires the right to use the asset for a short duration. Agreements of operating lease generally provide for an option to the lessee/lessor to terminate the lease after due notice. These agreements may generally be preferred by the lessee in the following circumstances:

- When the long-term suitability of asset is uncertain.
- When the asset is subject to rapid obsolescence.
- When the asset is required for immediate use to tide over a temporary problem.

Computers and other office equipments are the very common assets which form subject matter of many operating lease agreements.

(b) Financial Lease: As against the temporary nature of an operating lease agreement, financial lease agreement is a long-term arrangement, which is irrevocable during the primary lease period which is generally the full economic life of the leased asset. Under this arrangement lessor is assured to realize the cost of purchasing the leased asset, cost of financing it and other administrative expenses as well as his profit by way of lease rent during the initial (primary) period of leasing itself. Financial lease involves transferring almost all the risks incidental to ownership and benefits arising therefrom except the legal title to the lessee against his irrevocable undertaking to make unconditional payments to the lessor as per agreed schedule. This is a closed end arrangement with no option to lessee to terminate the lease agreement subsequently. In such lease, the lessee has to bear insurance, maintenance and other related costs. The choice of asset and its supplier is generally left to the lessee in such transactions. The variants under financial lease are as under:

- Lease with purchase option-where the lessee has the right to purchase the leased assets after the expiry of initial lease period at an agreed price.
- Lease with lessee having residual benefits-where the lessee has the right to share the sale proceeds of the asset after expiry of initial lease period and/or to renew the lease agreement at a lower rental.

In a few cases of financial lease, the lessor may not be a single individual but a group of equity participants and the group borrows a large amount from financial institutions to purchase the leased asset. Such transaction is called 'Leveraged lease'.

(c) Sales and Lease Back Leasing: Under this arrangement an asset which already exists and is used by the lessee is first sold to the lessor for consideration in cash. The same asset is then acquired for use under financial lease agreement from the lessor. This is a method of raising funds immediately required by lessee for working capital or other purposes. The lessee continues to make economic use of assets against payment of lease rentals while ownership vests with the lessor.

(d) Sales-Aid-Lease: When the leasing company (lessor) enters into an arrangement with the seller, usually manufacturer of equipment, to market the latter's product through its own leasing operations, it is called a 'sales-aid-lease'. The leasing company usually gets a commission on such sales from the manufacturers and increases its profit.

Apart from term loan and other facilities available from financial institutions including banks to a promoter to acquire equipment and other capital goods, the promoter now has an alternative option to acquire economic use of capital assets through leasing. The ultimate decision to either approach a financial institution or a leasing company will, however, depend on the nature of each such transaction.

3. ADVANTAGES

– The first and foremost advantage of a lease agreement is its flexibility. The leasing company in most of the cases would be prepared to modify the arrangement to suit the specific requirements of the lessee. The ownership of the leased equipment gives them added confidence to enable them to be more accommodative than the banks and other financial institutions.

- The leasing company may finance 100% cost of the equipment without insisting for any initial disbursement by the lessee, whereas 100% finance is generally never allowed by banks/financial institutions.
- Banks/financial institutions may involve lengthy appraisal and impose stringent terms and conditions to the sanctioned loan. The process is time consuming. In contrast leasing companies may arrange for immediate purchase of equipment on mutually agreeable terms.
- Lengthy and time consuming documentation procedure is involved for term loans by banks/institutions. The lease agreement is very simple in comparison.
- In short-term lease (operating lease) the lessee is safeguarded against the risk of obsolescence. It is also an ideal method to acquire use of an asset required for a temporary period.
- The use of leased assets does not affect the borrowing capacity of the lessee as lease payment may not require normal lines of credit and are payable from income during the operating period. This neither affects the debt equity ratio or the current ratio of the lessee.
- Leased equipment is an 'off the balance sheet' asset being economically used by the lessee and does not affect the debt position of lessee.
- By employing 'sale and lease back' arrangement, the lessee may overcome a financial crisis by immediately arranging cash resources for some emergent application or for working capital.
- Piecemeal financing of small equipments is conveniently possible through lease arrangement only as debt financing for such items is impracticable.
- Tax benefits may also sometimes accrue to the lessee depending upon his tax status.

4. DISADVANTAGES

- the lease rentals become payable soon after the acquisition of assets and no moratorium period is permissible as in case of term loans from financial institutions. The lease arrangement may, therefore, not be suitable for setting up of the new projects as it would entail cash outflows even before the project comes into operation.
- The leased assets are purchased by the lessor who is the owner of equipment. The seller's warranties for satisfactory operation of the leased assets may sometimes not be available to lessee.
- Lessor generally obtain credit facilities from banks etc. to purchase the leased equipment which are subject to hypothecation charge in favour of the bank. Default in payment by the lessor may sometimes result in seizure of assets by banks causing loss to the lessee.
- Lease financing has a very high cost of interest as compared to interest charged on term loans by financial institutions/banks.

Despite all these disadvantages, the flexibility and simplicity offered by lease finance is bound to make it popular. Lease operations will find increasing use in the near future.

5. EVALUATION OF LEASE

The most important part in lease financing is its evaluation both from the point of view of Lessee and Lessor.

5.1 From Lessee's Perspective

A lease can be evaluated either as an investment decision or as a financing means. If an investment decision has already been made, a firm (lessee) has to evaluate whether it will purchase the asset equipment or acquire it on lease basis. The lease rentals can be taken as interest on debt. Thus, leasing in essence is alternating source of financing to borrowing. The *lease evaluation thus is debt financing versus lease financing*.

There are three methods of evaluating a leasing proposal viz. Present Value analysis, Internal Rate of Return analysis, and the Bower Herringer Williamson method. These three methods are explained below with the help of an example.

Example

A leasing company expects a minimum yield of 10 % on its investment in the leasing business. It proposes to lease a machine costing ₹ 5,00,000 for ten years. Lease payments will be received in advance.

Evaluate the proposal of acquisition of machine from lessor's view point either by borrowing and buying or leasing assuming (a) borrowing rate of 16% (b) the income tax rate 50% (c) the operating costs are the same under lease and 'buy' alternatives (d) depreciation is allowable on straight line basis (e) residual value is 'nil'.

First we shall determine the Lease Rental to be charged by the Lessor Company:

The lease rental can be determined from the following equation:

$$₹\ 5{,}00{,}000 = x + \frac{x}{(1+0.1)} + \frac{x}{(1+0.1)^2} \cdots\cdots \frac{x}{(1+0.1)^9}$$

where x = lease rental per annum

$$₹\ 5{,}00{,}000 = x + 5.759x$$

$$x = \frac{₹\ 5{,}00{,}000}{6.759} = ₹\ 73{,}976$$

The above solution gives us the present value of one lease rental payment at time 0, plus the present value of nine lease rental payments at the end of each of the next nine years. We can find the present value discount factor for an even stream of cash flows for nine years to the capital recovery factor in D.C.F. analysis, where we recover principal and interest in equal installment during the specified period.

Now we analyze the decision of the Lessee company by following three approaches as follows:

5.1.1 Present Value Analysis (Net Advantage of Leasing)

In this method, the present value of the annual lease payments (tax adjusted) is compared with that of the annual loan repayments adjusted for tax shield on depreciation and interest, and the alternative which has the lesser cash outflow will be chosen.

Otherwise we can also define it as Net Advantage of Leasing (NAL) as follows:

NAL = PV of Cost of Owning – PV of Leasing

If NAL is positive, we should opt for leasing otherwise borrowing and buying option.

The discounting rate is the after-tax cost of borrowing i.e. 8% in our example.

Table 1 : Schedule of cash outflows : Leasing alternative

End of year	*Lease payment* ₹	*Tax shield cash outflows* ₹	*After tax of cash outflows* ₹	*Present value at 8%* ₹
0	73,976	–	73,976	73,976
1-9	73,976	36,988	36,988	2,31,064
10	–	36,988	(36,988)	(17,125)
				2,87,915

Table 2 : Schedule of debt repayments

The loan amount is repayable together with the interest at the rate of 16% on loan amount and is repayable in equal installments at the end of each year. The PVAF at the rate of 16% for 0-9* years is 5.6065, say 5.61 the amount payable will be

$$\text{Annual Payment} = \frac{₹\ 5,00,000}{5.61} = ₹\ 89,127\ \text{(rounded)}$$

* It is assumed that this loan will be repaid with interest in the same period as the term of the lease. This assumption places the loan on an equivalent basis with the lease.

End of year	*Interest plus principal payment* ₹	*Principal amount owing at the end of year* ₹	*Annual Interest @16%* ₹	*Principal component* ₹
0	89,127	4,10,873	–	89,127
1	89,127	3,87,486	65,740	23,387

2	89,127	3,60,357	61,998	27,129
3	89,127	3,28,887	57,657	31,470
4	89,127	2,92,382	52,622	36,505
5	89,127	2,50,036	46,781	42,346
6	89,127	2,00,915	40,006	49,121
7	89,127	1,43,934	32,146	56,981
8	89,127	77,836	23,029	66,098
9	90,290*	–	12,454	77,836
			3,92,433	5,00,000

*Difference in the last installment is due to rounding off of annuity factor to two decimal points.

Table 3 : Schedule of cash outflows in debt financing

End of year	*Annual loan repayment at 8%*	*Interest @16%*	*Depre-ciation*	*Tax shield*	*Net cash outflows*	*Present value of cash flows*
	(1)	(2)	(3)	(4) [(2) + (3) × t]	(5) (1) – (4)	(6)
	₹	₹	₹	₹	₹	₹
0	89,127	–	–	–	89,127	89,127
1	89,127	65,740	50,000	57,870	31,257	28,944
2	89,127	61,998	50,000	55,999	33,128	28,391
3	89,127	57,657	50,000	53,829	35,298	28,027
4	89,127	52,622	50,000	51,311	37,816	27,795
5	89,127	46,781	50,000	48,391	40,736	27,741
6	89,127	40,006	50,000	45,003	44,124	27,798
7	89,127	32,146	50,000	41,073	48,054	28,015
8	89,127	23,029	50,000	36,515	52,612	28,410
9	90,290	12,454	50,000	31,227	59,063	29,532
10	–	–	50,000	25,000	(25,000)	(11,575)
(t = tax rate)						3,32,205

The present value of cash outflows under lease financing is ₹ 2,87,915 while that of debt financing (i.e., owning this asset) is ₹ 3,32,205. Thus, leasing has an advantage over ownership in this case.

Or

NAL = ₹ 3,32,205 - ₹ 2,87,915 = ₹ 44,290

Since NAL is positive leasing is preferable.

5.1.2 Internal rate of return analysis

Under this method there is no need to assume any rate of discount. To this extent, this is different from the former method where the after-tax cost of borrowed capital was used as the rate of discount. The result of this analysis is the after-tax cost of capital explicit in the lease which can be compared with that of the other available sources of finance such as a fresh issue of equity capital, retained earnings or debt. Simply stated, this method seeks to establish the rate at which the lease rentals, net of tax shield on depreciation are equal to the cost of leasing. For the above example, the calculation of this rate i.e. cost of leasing is shown below:

Table 4 : Computation of cash flows for internal rate of return

End of year	*Cost of asset*	*Lease rental*	*Depreciation*	*Additional tax shield on lease rental*	*Net cash outflow*
(1)	**(2)**	**(3)**	**(4)**	**(5) ***	**(6) = [(3)–(5)]**
	₹	₹	₹	₹	₹
0	5,00,000	73,976	–	–	4,26,024
1	–	73,976	50,000	11,988	(61,988)
2	–	73,976	50,000	11,988	(61,988)
3	–	73,976	50,000	11,988	(61,988)
4	–	73,976	50,000	11,988	(61,988)
5	–	73,976	50,000	11,988	(61,988)
6	–	73,976	50,000	11,988	(61,988)
7	–	73,976	50,000	11,988	(61,988)
8	–	73,976	50,000	11,988	(61,988)
9	–	73,976	50,000	11,988	(61,988)
10	–		50,000	11,988	11,988

t = tax rate at 50%
*[(3) - (4)] × t

In the above table, the last column shows the cash flow stream. When we compute the rate of discount that equates the negative cash flows with the positive cash flows, we get, 5.4% (As shown below). This should be compared with the after-tax cost of debt finance i.e. 8%. Since the cost of lease is lower than after tax cost of debt finance, the former should be preferred.

Let us discount cash flows at 5%, then NPV is

₹ 4,26,024 + (₹ 61,988) X PVIFA (5%,9) + ₹ 11,988 X PVF (5%,10)

= ₹ 4,26,024 + (₹ 61,988) X 7.108 + ₹ 11,988 X 0.614

= ₹ 4,26,024 + (₹ 4,40,611) + ₹ 7,361 = - ₹ 7,226

Since the value is negative now we shall discount at higher rate say at 6%.

= ₹ 4,26,024 + (₹ 61,988) X 6.802 + ₹ 11,988X0.558

= ₹ 4,26,024 + (₹ 4,21,642) + ₹ 6,689 = ₹ 11,071

Using interpolation formula

$$= 5\% + \frac{-7226}{-7226 - 11071}(6\% - 5\%) = 5\% + \frac{7226}{18297} = 5\% + 0.395\% = 5.395\% \text{ say } 5.4\%$$

It will be noticed that there is no need to assume any cost of capital for discounting purposes in the IRR method unlike the Present value method. The management understands the IRR better than it does the Present Value. It is, therefore, considered that the IRR method may be preferred to the other methods.

5.1.3 Bower-Herringer-Williamson Method

This method segregates the financial and tax aspects of lease financing. If the operating advantage of a lease is more than its financial disadvantage or vice-versa lease will be preferred.

The procedure of evaluation is briefly as follows:

1. Compare the present value of debt with the discounted value of lease payments (gross), the rate of discount being the gross cost of debt capital. The net present value is the financial advantage (or disadvantage).
2. Work out the comparative tax benefit during the period and discount it at an appropriate cost of capital. The present value is the operating advantage (or disadvantage) of leasing.
3. If the net result is an advantage, select leasing.

   For the given example:

	₹
Present value of loan payments	5,00,000
Present value of lease payments discounted at 16%	4,15,005
i.e. ₹ 73,976 × 5.61 (1 + 4.61)	
Financial advantage	84,995

The present value of comparative tax-benefits i.e., the operating advantage (disadvantage) is calculated below:

Table 5 : Operating advantage (disadvantage) of lease

End of year	Tax shield,on leasing	Tax shield on borrowings	Incremental saving in tax due to leasing	Present value factor at 15%	Present value at 15%
(1)	(2)	(3)	(4) = (2)–(3)	(5)	(6)
	₹	₹	₹		₹
1	36,988	57,870	(20,882)	0.87	(18,167)
2	36,988	55,999	(19,011)	0.76	(14,448)
3	36,988	53,829	(16,841)	0.66	(11,115)
4	36,988	51,311	(14,323)	0.57	(8,164)
5	36,988	48,391	(11,403)	0.50	(5,702)
6	36,988	45,003	(8,015)	0.43	(3,446)
7	36,988	41,073	(4,085)	0.38	(1,552)
8	36,988	36,515	473	0.33	156
9	36,988	31,227	5,761	0.28	1,613
10	36,988	25,000	11,988	0.25	2,997
			Operating disadvantage		(57,828)

Note : The rate of 15% is considered to be the appropriate cost of capital.

Since the financial advantage exceeds the operating disadvantage in lease, it is advantageous to go for leasing.

5.1.4 Selection of Discount Rate

While examining the proposals of Lease Vs. Borrowing and Buying the selection of discounting rate for discounting is an issue. Related cash flows can be discounted both at the rate of Post Tax Cost of Debt and Cost of Capital and final decision will be same. However, since leasing is substitute for borrowing option, post-tax cost of debt is a good option for discounting.

5.2 From Lessor's Perspective

The leasing evaluation from view point of Lessor in fact a Capital Budgeting Decision involving financing of asset out of the funds acquired from various sources involving some costs.

Accordingly, Lessor would like to invest only if it has positive return. In other words, the Lessor would be ready for the financing proposal if the return from it is more than cost of funds involved.

Like traditional capital budgeting decision, the Lessor can accept the proposal of financing on the following methods of evaluation:

(i) Net Present Value (NPV) Method: The Lessor would accept the proposal of financing the asset if NPV of the same is zero or more. If it is negative, then it would not be accepted as it would not be beneficial to accept the proposal.

(ii) Internal Rate of Return (IRR) Method: In terms of IRR Method the financing proposal should be accepted only if computed IRR of cash flows is more than the required cut-off rate or Cost of Capital or Weighted Average Cost of Capital (WACC).

Like Capital Budgeting Decision the various types of Cash flows involved in financing decisions are as follows:

(a) Initial Cash Outflow: Like in Capital Budgeting decision, the initial cash outflow in financing proposal involves the Purchase Price of Machine and incidental expenses thereto.

(b) Annual Cash Flows: The Annual Cash Flow shall be accrued in the form of Annual Lease Rental adjusted in light of tax benefits on Depreciation and tax liability. Accordingly, it can be computed as follows:

= (Lease Rental – Depreciation) X (1 – t) + Depreciation

(c) Terminal Cash Flows: Just like in the terminal year of a project in financing proposal, the terminal cash flow involved is disposal/ salvage value of the asset financed net of Tax Adjustment on Short Term Capital Loss or Gain, if any.

In case of NPV method, the above mentioned cash flows are discounted at Cost of Capital and in IRR Method, the Cut Off rate is computed from these Cash Flows and compared with Cost of Capital or WACC.

6. BREAK EVEN LEASE RENTAL (BELR)

Break-Even Lease Rental can be viewed both from the perspective of lessee as well as the lessor.

6.1 Break Even Lease Rental (BELR) from Lessee's point of view

From the point of view of lessee, the BELR is the rental at which the lessee is indifferent between borrowing and buying option and lease financing option. In other words, he can opt for any one option. At this rental the Net Advantage of Leasing (NAL) will be zero. It can also be defined as maximum lease rental the lessee would be willing to pay.

In case if BELR is less than the actual lease rent payable, the lease option would not be viable.

6.2 Break Even Lease Rental (BELR) from Lessor's point of View

From the lessor's view point, BELR is the minimum (floor) lease rental, which he should accept. In this case also NAL should be zero. Any lease rent below BELR should not be accepted. It is to be noted that while computing NAL, the over all cost of capital of the firm should be used. The computation of BELR from lessor's point of view can be understood with the help of following illustration.

Illustration

With the following data available compute, the BELR that ABC Ltd. should charge from lessee.

Cost of Machine	₹ 150 Lakh
Expected Useful Life	5 year
Salvage Value of Machine at the end of 5 years	₹ 10 lakh
Rate of Depreciation (WDV)	25%
K_o	14%
Applicable Tax Rate	35%

Machine will constitute a separate block for depreciation purpose.

Solution

Cost of Machine	₹ 150,00,000
Less: - PV of Salvage Value (W1)	₹ 5,19,400
Less: PV of Tax benefit on Depreciation (W2)	₹ 27,34,184
Less: PV of Tax Saving on STCL at the end of 5 year (W3)	₹ 6,80,478
	₹ 110,65,938
PVIFA for 5 years @14%	3.433

After tax Break Even Lease Rental = $\frac{1,10,65,938}{3.433}$ = 32,23,400

Before Tax BELR = $\frac{32,23,400}{(1-0.35)}$ = ₹ 49,59,100

Working Notes

W1

Salvage Value	=	₹ 10,00,000
PVF @14%	=	0.5194
PV of Salvage Value	=	₹ 5,19,400

W2

Table showing calculation of PV of Tax Benefit on Depreciation

Year	Opening WDV	Depreciation @ 25%	Closing WDV	PVF @14%	PV
	(₹)	(₹)	(₹)		(₹)
1	150,00,000	37,50,000	11,250,000	0.877	32,88,750
2	112,50,000	28,12,500	84,37,500	0.769	21,62,813
3	84,37,500	21,09,375	63,28,125	0.675	14,23,828
4	63,28,125	15,82,031	47,46,094	0.592	9,36,562
					78,11,953

Tax Benefit on Depreciation = ` 78,11,953 X 0.35 = ` 27,34,184

W3

PV of Tax benefit on Short Term Capital Loss (STCL)

WDV at begining of 5 year as per above table	47,46,094
Less: Salvage Value	10,00,000
STCL	37,46,094
Tax Benefit	13,11,133
PVF at 14%	0.519
PV of Tax Benefit on STCL	6,80,478

7. CROSS-BORDER LEASING

Cross-border leasing can be considered as an alternative to equipment loans in some emerging foreign market, where finance leases are treated as conditional sales agreements. The only difference between international leasing and loans will be the documentation, with down payments, payment streams, and lease-end options the same as offered under **Equipment Loans to Foreign Buyers.** The various kinds of leasing arrangements available in the U.S. market are not yet feasible in most cases for cross-border leasing transactions. There are however, attempts to develop more flexible international leasing structures for export financing. Operating leases may be feasible for exports of large equipment with a long economic life relative to the lease term.

Cross-border leasing is a leasing arrangement where lessor and lessee are situated in two different countries. This raises significant additional issues relating to tax avoidance and tax shelters.

Cross-border leasing has been widely used in some European countries, to arbitrage the difference in the tax laws of different countries. Typically, this rests on the premise that, for tax purposes, some assign ownership and the attendant depreciation allowances to the entity that has legal title to an asset, while others assign it to the entity that has the most of the use (legal title being only one of several factors taken into account). In these cases, with sufficiently long leases (often 99 years), an asset can end up with two effective owners, one each in different countries, this is often referred to as a double-dip lease.

Often the original owner of an asset is not subject to taxation in any country and therefore not able to claim depreciation. The transaction often involves an entity selling an asset (such as sewerage system or power plant) to an investor (who can claim depreciation), and long-term leasing it right back (often referred to as a sale leaseback).

Leasing techniques had been used for financing purposes for several decades throughout the world. The practice was developed as a method of financing aircraft. Several airlines entities in the early 1970s were unprofitable and very capital intensive. These airlines had no need for the depreciation deductions generated by their aircraft and were significantly more interested in reducing their operating expenses. A very prominent bank purchased aircraft and leased them to the airlines and because the bank was able to claim depreciation deductions for those aircraft, the bank was able to offer lease rates that were significantly lower than the interest payments that airlines would have to pay on an aircraft purchase loan (and most commercial aircraft flying today are operated under a lease). In the United States, this spread into leasing the assets of U.S. entities and governmental entities and eventually evolved into cross-border leasing.

One significant evolution of the leasing industry involved the collateralization of lease obligations in sale leaseback transactions. For example, an entity would sell an asset to a bank, the bank would require lease payment and give an entity an option to repurchase the asset, the lease obligations were low enough (due to the depreciation deductions the banks were now claiming) so that the entity could pay for the lease obligations and fund the repurchase of the asset by depositing most but not all of the sale proceeds in an interest bearing account. This resulted in the entity having pre-funded all of its lease obligations as well as its option to repurchase the asset from the bank for less than the amount received in the initial sale of the asset so the entity would be left with additional cash after having pre-funded all of its lease obligations.

This gave the appearance of entities entering into leasing transactions with banks for a fee. By the late 1990s many of such leasing transactions were with entities in Europe. However, in 1999 cross border leasing in the United States was “stopped” by the effective shutdown of LILOs (lease-in/lease outs). LILOs were significantly more complicated than the typical lease where an owner (for example) would lease an asset to a bank and then lease it back from the bank for a shorter period of time.

Cross-border leasing has been in practice as a means of financing infrastructure development in emerging nations. Cross-border leasing may have significant applications in financing infrastructure development in emerging nations – such as rail and air transport equipment, telephone and telecommunications equipment and assets incorporated into power generation and distribution systems and other projects that have predictable revenue streams.

A major objective of cross-border leases is to reduce the overall cost of financing through utilization by the lessor of tax depreciation allowances to reduce its taxable income. The tax savings are passed through to the lessee as a lower cost of finance. The basic prerequisites are relatively high tax rates in the lessor's country liberal depreciation rules and either very flexible or very formalistic rules governing tax ownership.

Other important objectives of cross border leasing include the following:

- The lessor is often able to utilize nonrecourse debt to finance a substantial portion of the equipment cost. The debt is secured by among other things, a mortgage on the equipment and by an assignment of the right to receive payments under the lease.
- Also, depending on the structure, in some countries the lessor can utilize very favourable "leveraged lease" financial accounting treatment for the overall transaction.
- In some countries, it is easier for a lessor to repossess the leased equipment following a lessee default because the lessor is an owner and not a mere secured lender.
- Leasing provides the lessee with 100% financing.

While details may differ from one transaction to another, most leasing structures are essentially similar and follow the "sale-leaseback" pattern. The principal players are (i) one or more equity investors; (ii) a special purpose vehicle formed to acquire and own the equipment and act as the lessor; (iii) one or more lenders, and (iv) the lessee. The lease itself is a "triple-net lease" under which the lessee is responsible for all costs of operation, maintenance and insurance.

In many transactions, the lessee's fixed payment obligations are prefunded or "defeased" through an up-front payment (in an amount equal to the present value of the fixed payment obligations) to a financial entity that assumes such obligations. The benefits of defeasance include (i) the lessee can lock in its financial savings by making the defeasance payment; (ii) by routing the lease payments through the defeasance entity's jurisdiction, withholding taxes applicable to lease payments in the lessee's jurisdiction may possibly be avoided; (iii) defeasance serves to some extent as a credit enhancement technique for the lessor, and (iv) defeasance may eliminate or reduce currency risk exposure.

In order for the lessor to obtain the tax benefits associated with equipment leasing, most countries require that the lease be treated as a "true lease" for tax purposes, as opposed to a conditional sale or other secured financing arrangement. This objective generally can be satisfied if the lessor has "tax ownership" of the leased equipment.

Each country applies different rules for determining whether the party acting as lessor under a cross-border lease is the "owner" of the leased asset for tax purposes and is thereby entitled to claim tax allowances. In the United States and some other countries, the principal focus is on whether the lessor possesses substantially all attributes of economic ownership of the leased asset. Other countries such as the United Kingdom and Germany apply more formalistic property law concepts and focus primarily on the location of legal title, although these countries usually also require that the lessor have some attributes of economic ownership or, at least, that the lessee have only a minimal economic interest in the equipment. In Japan, ownership of legal title is essential, but the lessor is only required under current law to obtain nominal incidents of economic ownership (all that is required is that the lease will provide a return of the equity investment plus a pre-tax profit of 1% of equipment cost). While Japan does have detailed tax lease guidelines, these guidelines are designed primarily to circumscribe the tax benefits available to the lessor in a cross-border lease to prevent undue tax deferral; they do not require the lessor to have a significant economic interest in the leased equipment.

The non-tax issues associated with cross-border leasing can best be described by reference to the various structural risks that may arise in a given transaction and must be addressed in the documentation.

8. REGULATORY ASPECTS OF LEASING

A Leasing Company is a Non-Banking Financial Company as per the FAQs given in the RBI Website https://www.rbi.org.in. So, in a way, it has to get itself registered with RBI. The reason is that in terms of Section 45-IA of the RBI Act, 1934, no Non-banking Financial company can commence or carry on business of a non-banking financial institution without obtaining a certificate of registration from the RBI.

Further, as per Section 45-IA of the said Act, no non-banking financial company shall commence or carry on the business of a non-banking financial institution without–

(a) obtaining a certificate of registration issued under this Chapter; and

(b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding two hundred lakh rupees, as the RBI may, by notification in the Official Gazette, specify.

Meaning of "net owned fund"

It means–

(a) the aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance-sheet of the company after deducting therefrom– (i) accumulated balance of loss; (ii) deferred revenue expenditure; and (iii) other intangible assets; and

(b) further reduced by the amounts representing investments of such company in shares of – (i) its subsidiaries; (ii) companies in the same group; (iii) all other non-banking financial companies;

Further, an Equipment Leasing Company has been an eligible NBFC for the purpose of acceptance of deposits by NBFCs defined in paragraph 2(1) of the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998. As per the said directions, Equipment Leasing (EL) means any company which is a financial institution carrying on as its principal business, the activity of leasing of equipment.

CHAPTER 17

FACTORING

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Concept, Definition and Mechanism of Factoring
- Types/Forms of Factoring
- Functions of a Factor
- Benefits of Factoring
- Factors inhibiting the growth of Factoring in India
- Forfaiting
- Forfaiting vs Export Factoring
- Regulatory Aspects of Factoring

1. INTRODUCTION TO FACTORING

This concept has not been fully developed in our country and most of their work is done by companies themselves. All units' particularly small or medium size units have to make considerable efforts to realize the sale proceeds without much success creating functional difficulties for such units.

Many units under small-scale sector have become sick only because of delay/non-realization of their dues from large units. Introduction of factoring services will, therefore, prove very beneficial for such units as it will free the units from hassles of collecting receivables to enable them to concentrate on product development and marketing.

2. DEFINITION AND MECHANISM

2.1 Definition and Concept

Basically, factoring is a kind of financial service in which a business organization sells its Account Receivables to another person, called a factor, at a discount in order to raise money.

Factoring is different from bill discounting. In bill discounting invoice are discounted at a certain rate to get the funds, whereas the concept of factoring is broader. In the factoring process, the Account Receivables are sold to an outside agency.

Example - The seller sold good on credit and raised the invoice. However, the seller needs immediate money to meet its working capital requirements i.e. meeting day to day expenses of the business. For this purpose, he sold the goods to an outside agency i.e. a factor. The factor pays the required amount to the seller after some deducting some amount. So, the entire invoice amount is not paid by the factor. Rather, about 70-80% of the bill amount is paid by the factor. The remaining amount is paid after the factor receives the entire bill amount from the customers (debtors). The factor charges some commission for providing these services.

The study group appointed by the International Institute for the Unification of Private Law (UNIDROIT), Rome, during 1988, recommended, in general terms, the definition of factoring as under:

"Factoring means an arrangement between a factor and his client which includes at least two of the following services to be provided by the factor:

- Finance
- Maintenance of debt
- Collection of debts
- Protection against credit risk".

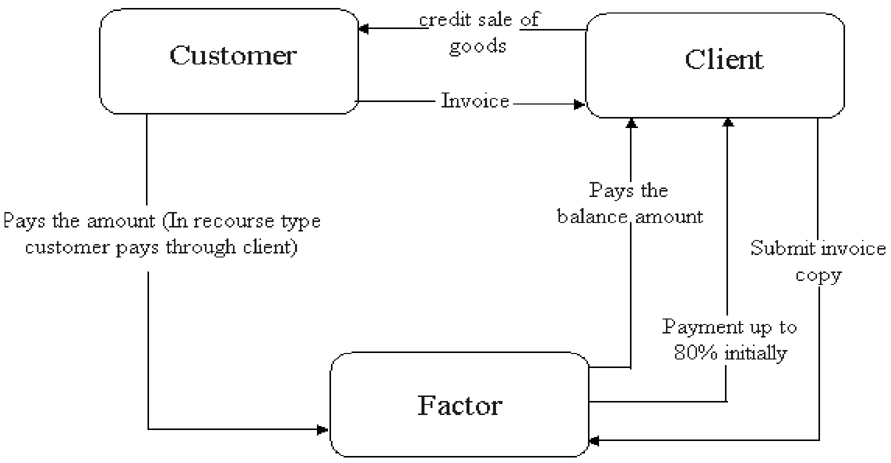
However, the above definition applies only to factoring in relation to supply of goods and services: (i) across national boundaries; (ii) to trade or professional debtors; (iii) when notice of assignment has been given to the debtors. Domestic factoring is not yet a well-defined concept and it has been left to the discretion of legal framework as well as trade usage and convention of the individual country.

In India factoring is undertaken by different bank subsidiaries like SBI Factors and Commercial Services Ltd. Promoted by SBI and Canara Bank Factors Ltd. promoted jointly by Canara Bank, Andhra Bank and SIDBI.

2.2 Mechanism of Factoring

In a factoring transaction, there are three parties – the factor, the client and the customers of the client. The client is the person who is actually availing the factoring service. The factor provides the factoring services and the customers are the persons who purchases the goods and services on credit.

The mechanism of the factoring process has been depicted in the following diagram.



The following steps are involved in the process of factoring as shown in the above diagram:

(i) Customer places an order with the client for purchase of goods and/or services on credit.

(ii) On the basis of agreement, the client delivers the goods and sends the invoice to customers.

(iii) The client then assigns the invoice to the factor. This is generally called, "Call sale of book debts by the client firm to the factor".

(iv) The factor, then, makes prepayment up to 80 per cent of the invoice value to the client.

(v) The client pays interest on advances of amount received until the cash is collected from customer.

(vi) The factor maintains accounts receivable of the client and sends periodical statements to the customer to accelerate the collection.

(vii) On the due date, the factor collects the invoice amount from the customer.

(viii) After that, the factor releases the remaining amount to the client after adjusting his commission/fees.

Aforesaid steps can be explained with the help of an ***example****:*

Suppose Customer/Client has raised an order with an invoice value of ₹ 500000; basis that order business delivered the product on credit basis. After this, the business sells the invoice to factoring company to get at least 80 per cent realized value i.e. ₹ 400000.

This realized value can be used for further business expansion or any product development.

The business pays an interest i.e. 5% on the advance of ₹ 400000 until amount realized from client. Then factoring company collects the invoice amount from customer i.e ₹ 500000. After this factoring company releases the reserve amount i.e. ₹ 1,00,000 less 5% interest charged.

In this Debtor financing process, factoring charges also played a vital role for providing the services. The following factoring charges are levied:

- **Finance charges** – Computed on the prepayment outstanding in the client's a/c at monthly intervals. Finance charges are only for financing that has been availed by the client. These charges are similar to interest levied on the cash credit facilities in a bank.
- **Service fee –** It is a nominal charge at monthly interval to cover the cost services namely - collection, MIS reports, sales ledger management etc. Service fee is determined on the basis of total gross value, no. of customers, degree of credit risk etc.

3. TYPES/FORMS OF FACTORING

Depending upon the features built into the factoring arrangement to cater to the varying needs of trade/citizens, there can be different kinds of factoring:

(i) Recourse and Non-recourse Factoring: Under a recourse factoring arrangement, the factor has recourse to the client (firm) if the debt purchased/receivable factored turns out to be irrecoverable. In other words, the factor does not assume credit risks associated with the receivables.

In case of non-recourse factoring, the factor does not have the right to recourse. The loss arising out of irrecoverable receivables is borne by the factor, as a compensation for which he charges a higher commission.

(ii) Advance and Maturity Factoring: In advance factoring, the factor paid a pre specified portion, ranging between three-fourths to nine tenths, of the factored receivables in advance, the balance being paid upon collection/on the guaranteed payment date. A drawing limit, as a pre-payment, is made available by the factor to the client as soon as the factored debts are approved/the invoices are accounted for. The client has to pay interest (discount) on the advance/repayment between the date of such payment and the date of actual collection from the customers/or the guaranteed payment date, determined on the basis of the prevailing short-term rate, the financial standing of the client and the volume of the turnover.

In maturity factoring, the factoring agency does not provide any advance to the firm. In fact, the factor makes payment to his client after collecting the amount from the customers at the end of the maturity period.

(iii) Full Factoring: This is the most comprehensive form of factoring combining the features of all the factoring services specially those of non-recourse and advance factoring. It is also known as Old Line Factoring.

(iv) Disclosed and Undisclosed Factoring: In Disclosed Factoring, the name of the factor is disclosed in the invoice by the supplier-manufacturer of the goods asking the buyer to make payment to the factor.

However, in Undisclosed Factoring, the name of the factor is not disclosed in the invoice although the factor maintains the sales ledger of the supplier-manufacturer. The entire realization of the business transaction is done in the name of the supplier company but all control remains with the factor.

(v) Domestic and Export/Cross Border Factoring: If the three parties involved, namely, customer (buyer), client,(seller-supplier) and factor (financial intermediary) are domiciled in the same country then it is known as domestic factoring. There are usually four parties involved in a cross border factoring transaction. They are:

a) Exporter (client)

b) Importer (customer)

c) Export factor

d) Import Factor

It is also known as two-factor system.

4. FUNCTIONS OF A FACTOR

The main functions of a factor could be classified into five categories:

- **Maintenance/administration of sales ledger:** The factor maintains the clients' sales ledgers. On transacting a sales deal, an invoice is sent to the customer and a copy of the same is sent to the factor. The factor also gives periodic reports to the client.
- **Collection facility:** The factor undertakes to collect the receivables on behalf of the client relieving him of the problems involved in collection, and enables him to concentrate on other important functional areas of the business. It also enables the client to reduce the cost of collection by way of savings in manpower, time and efforts.
- **Financing Trade Debts:** The unique feature of factoring is that a factor purchases the book debts of its clients at a price and the debts are assigned in favour of factor who is usually willing to grant advances to the extent of 80% of the assigned debts.
- **Credit Control and Credit Protection:** Assumptions of credit risk is one of the most important functions of the factor. This service is provided where debts are factored without recourse. The factor in consultation with the client fixes credit limits for approved customers.
- **Advisory Services :** By virtue of their specialized knowledge and experience in finance and credit dealings and access to extensive credit information; factors can provide the following

information services to the clients:

(i) Customer's perception of the client's products, changing in marketing strategies, emerging trends etc.

(ii) Audit of the procedures followed for invoicing, delivery and dealing with sales returns.

(iii) Introduction to the credit department of bank/subsidiaries of banks engaged in leasing, hire-purchase, merchant banking.

5. BENEFITS OF FACTORING

The benefits of factoring have been discussed as follows:

- Factoring provides immediate cash flow in the form of 80% of the invoice value which helps in building the liquidity position of the client. Also, this proportion of finance is higher than bank finance against credit sales.
- It also plays an important role in client's working capital finance.
- The cash realized by receiving advance amount from the factor can be used to accelerate the production cycle.
- The client need not have to spend time on sales ledger maintenance, follow up and collection of receivables as this can be done by factoring company who buys such receivables. This helps in saving the precious time of the client as it can concentrate on its core activities such as production, marketing etc.
- This provides comprehensive credit control system which helps in assessing the quality of debtors and monitoring their financial health.

The factoring process helps in reducing the average receivables collection period. As a result, the total operating cycle time of the client is also reduced. This will ultimately leads to efficient working capital management.

6. FACTORS INHIBITING THE GROWTH OF FACTORING IN INDIA

The factoring industry has grown up rapidly around the world. More than one lakh businesses are currently using factoring to settle their trade transaction. However, the factoring market in India is minuscule.

There are various factors which inhibits the overall growth of factoring markets in India which are described as below:

(i) Lack of credit appraisal system and authentic client data base have restricted the growth model of factoring and its arrangements.

(ii) Higher stamp duty while assigning the invoice to the factor will increase the cost of the client which leads to reduction in factoring arrangements.

To remove the above limitations and expand the factoring market in India, the following can be suggested:

(i) Do away with stamp duty or at least reduce it.

(ii) Incorporate a separate company which will give a true and fair credit appraisal report and which will cover all aspect of client's information and their accounts.

(iii) Factoring companies should expand their network and branches especially to those localities where small scale units are located.

(iv) Work shop and seminars should be organized by factoring companies to enhance awareness and usefulness of the factoring process.

7. FORFAITING

Forfaiting is a form of financing of receivables pertaining to international trade. It denotes the purchase of trade bills/promissory notes by a bank/financial institution without recourse to the seller. The purchase is in the form of discounting the documents covering the entire risk of non-payment in collection. All risk and collection problems are fully the responsibility of the purchaser (forfaiter) who pays cash to the seller after discounting the bills/notes.

Difference between Forfaiting vs Export Factoring

(a) A forfaiter discounts the entire value of the note/bill. In a factoring arrangement the extent of financing available is 75-80%.

(b) The forfaiter's decision to provide financing depends upon the financing standing of the availing bank. On the other hand in a factoring deal the export factor bases his credit decision on the credit standards of the exporter.

(c) Forfaiting is a pure financial agreement while factoring includes ledger administration as well as collection.

(d) Factoring is a short-term financial deal. Forfaiting spreads over 3-5 years.

8. SOME ILLUSTRATIONS IN FACTORING

Illustration 1

A Ltd. has annual credit sales of ₹ 219 lakh and its average collection period is 50 days. The past experience indicates that bad debt losses are around 2% of credit sales. The factoring is expected to save ₹ 2 lakh in administration costs and also to eliminate all bad debt losses. The factor has agreed to advance 80% of the receivables at 15% p.a. Compute the net factoring cost if factoring commission is 2%.

Solution

Average receivable = (₹ 219lakh/365) X 50 = ₹ 30 lakh

Factoring Commission = 2% on ₹ 30 lakh = ₹ 0.6 lakh

Amount available for advance = 80% of ₹ 30 lakh – Factoring commission (₹ 0.6 lakh) = ₹ 23.4 lakh.

The factor will actually remit the advance net of interest for 50 days.

The annual rate of interest is 15% and so rate of interest for 50 days = (15/365) x 50 = 2.05%

Interest for 50 days on ₹ 23.4 lakh = 2.05% on ₹ 23.4 lakh = ₹ 0.48 lakh

The advance remitted to client = ₹ 23.4 lakh – ₹ 0.48 lakh= ₹ 22.92 lakh

Factoring cost for 50 days = Factoring commission + Interest

= ₹ 0.6 lakh + ₹ 0.48 lakh = ₹ 1.08 lakh

Factoring cost for year = (₹ 1.08 lakh) x (365/50) = ₹ 7.884 lakh

Net Factoring Cost

Particulars		₹ lakh
Factoring cost per year		7.884
Less: Costs saved per year		
Bad Debt = 2% on ₹ 219 lakh	4.38	
Administration cost saved	2.00	6.380
Net Factoring cost per year		1.504
Advance		22.920
Net Factoring cost per year (%) = (1.504/22.92) X 100		6.56%

Illustration 2

A Ltd. has a total sales of ₹ 3.2 crores and its average collection period is 90 days. The past experience indicates that bad-debt losses are 1.5% on Sales. The expenditure incurred by the firm in administering its receivable collection efforts are ₹ 5,00,000. A factor is prepared to buy the firm's receivables by charging 2% Commission. The factor will pay advance on receivables to the firm at an interest rate of 18% p.a. after withholding 10% as reserve.

Calculate the effective cost of factoring to the Firm.

Solution

	₹
Average level of Receivables = 3,20,00,000 × 90/360	80,00,000
Factoring commission = 80,00,000 × 2/100	1,60,000
Factoring reserve = 80,00,000 × 10/100	8,00,000
Amount available for advance =₹ 80,00,000 – (1,60,000 + 8,00,000)	70,40,000
Factor will deduct his interest @ 18%:-	
Interest $= \dfrac{₹\ 70,40,000 \times 18 \times 90}{100 \times 360}$	= ₹ 3,16,800

∴ Advance to be paid = ₹ 70,40,000 – ₹ 3,16,800 = ₹ 67,23,200

Annual Cost of Factoring to the Firm:	₹
Factoring commission (₹ 1,60,000 × 360/90)	6,40,000
Interest charges (₹ 3,16,800 × 360/90)	12,67,200
Total	19,07,200

Firm's Savings on taking Factoring Service:	₹
Cost of credit administration saved	5,00,000
Cost of Bad Debts (₹ 3,20,00,000 × 1.5/100) avoided	4,80,000
Total	9,80,000
Net cost to the Firm (₹ 19,07,200 – ₹ 9,80,000)	9,27,200
Effective rate of interest to the firm = $\dfrac{₹\ 9,27,200 \times 100}{67,23,200}$	13.79%

Note: The number of days in a year has been assumed to be 360 days.

9. REGULATORY ASPECTS OF FACTORING

In India, Regulatory Aspects of Factoring can be referred from Factoring Regulation Act, 2011 and Non-Banking Financial Company - Factors (Reserve Bank) Directions, 2012.

9.1 Provisions in brief from the Factoring Regulation Act, 2011

(i) No factor shall commence or carry on the factoring business unless it obtains a certificate of registration from the Reserve Bank to commence or carry on the factoring business under this Act.

For the removal of doubts it is hereby clarified that a non-banking financial company engaged in factoring business shall be treated as engaged in factoring business as its "principal business" if it fulfils the following conditions, namely:—

(a) If its financial assets in the factoring business are more than fifty per cent. of its total assets or such per cent. as may be stipulated by the Reserve Bank; and

(b) If its income from factoring business is more than fifty per cent. of the gross income or such per cent. as may be stipulated by the Reserve Bank.

(ii) The Reserve Bank may, if it considers necessary in the interest of business enterprises availing factoring services or in the interest of factors or interest of other stake holders give directions to the factors either generally or to any factor in particular or group of factors in respect of any matters relating to or connected with the factoring business undertaken by such factors. If any factor fails to comply with any direction given by the Reserve Bank, the Reserve Bank may prohibit such factor from undertaking the factoring business.

The person who has to receive any amount from the debtors or who is owner of any receivable shall, at the time of entering an agreement with the factor disclose to the factor any defences and right of set off that may be available to the debtor. Upon entering the agreement, any security created to secure the payment of receivable shall vest in the factor and he is eligible to exercise all the rights and remedies whether by way of damages or otherwise which would otherwise available to the owner of receivable.

Before demanding any payment from the debtors, the factor shall give a proper notice to him. After receiving the notice, the debtors shall make the required payment to the factor and this will fully discharge the liability of the debtor.

In case, no notice for payment is received by the debtor, and he makes the required payment to the owner of receivable, such amount shall be paid forthwith by him to the factor. So, the owner of the receivable acts as a trustee in this situation and he holds the amount received from the debtor in trust for the factor.

If any modification in the original contract takes place between the owner of receivable and the factor, will not be binding against the factor unless he consents to it. If the owner of receivable commits any breach of original contract with debtor, the debtor can claim any loss or damage caused to him in consequence of that.

Every factor shall for the purpose of registration, file the particulars of every transaction of assignment of receivables to the Central Registry to be set up under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 within 30 days from the date of such assignment or from the date of establishment of such registry.

9.2 As per the Non-Banking Financial Company - Factors (Reserve Bank) Directions, 2012

Following additional points may be noted with relation to factoring in this regard:

(i) An entity not registered with the Reserve Bank of India (RBI) may conduct the business of factoring if it is an entity mentioned in Section 5 of the Act i.e. a bank or any corporation established under an Act of Parliament or State Legislature, or a Government Company as defined under section 617 of the Companies Act, 1956.

(ii) Every company seeking registration as NBFC-Factor shall have a minimum Net Owned Fund (NOF) of ₹ 5 crore. Existing companies seeking registration as NBFC-Factor but do not fulfil the NOF criterion of ₹ 5 crore may approach the Bank for time to comply with the requirement.

(iii) A new company that is granted Certificate of Registration (CoR) by the RBI as NBFC-Factor shall commence business within six months from the date of grant of CoR by the RBI.

(iv) An NBFC-Factor shall ensure that its financial assets in the factoring business constitute at least 50 per cent of its total assets and the income derived from factoring business is not less than 50 per cent of its gross income.

Final Course

(Revised Scheme of Education and Training)

Study Material

Elective Paper 6B

Financial Services and Capital Markets

Part – B

BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

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SYLLABUS

PAPER 6 B : FINANCIAL SERVICES AND CAPITAL MARKETS

(One paper – Three hours – 100 marks)

Objective:

1. To gain knowledge of financial services rendered by intermediaries and banks and their role and activities in the financial market in general and capital markets in particular;
2. To acquire the ability to apply such knowledge to address issues in practical scenarios.

Contents:

1. Global Financial Markets

- Introduction to Global Financial Market
- Role of Financial Market in Economic Development of a country
- Stakeholders in Financial Market (Domestic and Global)
- Indian Financial Market scenario

2. Impact of various Policies of Financial Markets

- Credit Policy of RBI
- Fed Policy
- Inflation Index, CPI, WPI, etc.

3. Capital Market - Primary

- New Issue Market – Domestic and Global
- Private Placement , QIP, Disinvestment
- Right Issue

4. Capital Market - Secondary

- Secondary Market
- Stock Market Operations
- Indian Debt Market

5. Money Market

- Basics of Money Market
- Money Market Participants
- Money Market Instruments
- Repo and Reverse Repo
- CRR, SLR
- MIBOR, LIBOR
- Government Securities Market

6. Institutions and Intermediaries

- Depository
- Stock and Commodity Exchanges – Indian and Global
- Intermediaries
- Institutional Investors
- FPIs
- Custodians
- Clearing Houses

7. Commodity Market

- What are Commodity Markets
- Role of Commodity Markets
- Commodity Market in India
- Application of Derivative in Commodities
- Global Commodities Exchanges

8. Banking as source of Capital including NBFCs

- Concept of Project Financing
- Working Capital Management
- Reverse Mortgage

9. Mutual Funds

- Meaning

- Evolution
- Types
- Performance Measures, NAV
- Mutual Fund Organisation
- Advantages and Disadvantages of Mutual Fund
- Exchange Traded Funds (ETFs)
- Real Estate Investment Trusts (ReITs)
- Infrastructure Investment Trusts (Invits)

10. Private Equity

- Meaning and Classification
  - ❖ Venture Capital
  - ❖ Buyouts
  - ❖ Special Cases
  - ❖ Hurdle rate
  - ❖ Paid in Capital
  - ❖ Term Sheet
- Cost of Investing in Private Equity
- Exit Routes
- Valuation of Private Equity Transactions
- Private Equity Funds (Distribution of returns in General Partner and Limited Partners)

11. Investment Banking

- Concept
- Functions
- Challenges
- Developments in Investment Banking
- Merchant Banking and issue management

12. Credit Rating

- Introduction

- Rating Services
- Objectives and types
- Uses
- Credit Rating Process
- Credit Rating Methodology
- Rating Revisions
- Credit Rating Agencies in India and abroad
- Limitations with case studies

13. Treasury Operations

- Raising and Deployment of Funds
- Risk Management

14. Risk Management

- Preventive Controls
- Early Signals
- Credit Risk

15. Credit Derivatives

- Credit Default Swaps
- Collateralized Debt Obligations (CDO)
- Pricing of Credit Derivative Instruments

16. Leasing

- Meaning, types, advantages and disadvantages of Leasing
- Financial evaluation of lease proposal from perspective of Lessee and Lessor
- Break Even Lease Rental (BELR) from Lessee's and Lessor's point of view
- Cross Border Leasing
- Regulatory Aspects of Leasing

17. Factoring

- Concept, Definition and Mechanism of Factoring
- Types/Forms of Factoring

- Functions of a Factor
- Benefits of Factoring
- Factors inhibiting the growth of Factoring in India
- Forfaiting
- Forfaiting vs Export Factoring
- Regulatory Aspects of Factoring

18. SEBI Guidelines

Following topic are covered in the paper of Strategic Financial Management (Paper – 2) and Corporate and Economic Laws (Paper – 4) also forms the part of the syllabus

- Securitization
- Fixed Income Securities (Valuation of Bonds/ Debentures)
- Derivatives
- Interest Rate Risk Management
- The Securities and Exchange Board of India Act, 1992
- Legislative framework on listing agreements
- The Securities Contract (Regulation) Act, 1956
- Chapter III-D of the RBI Act, 1934

BEFORE WE BEGIN …

Revised Scheme of Education and Training: Bridging the competence gap

The role of a chartered accountant is evolving continually to assume newer responsibilities in a dynamic environment. There has been a notable shift towards strategic decision making and entrepreneurial roles that add value beyond traditional accounting and auditing. The causative factors for the change include globalization leading to increase in cross border transactions and consequent business complexities, significant developments in information and technology and financial scams underlining the need for a stringent regulatory set up. These factors necessitate an increase in the competence level of chartered accountants to bridge the gap in competence acquired and competence expected from stakeholders. Towards this end, the scheme of education and training is being continuously reviewed so that it is in sync with the requisites of the dynamic global business environment; the competence requirements are being stepped up to enable aspiring chartered accountants to acquire the requisite professional competence to take on new roles.

Introducing "Electives": Significant feature of the Revised Scheme of Education and Training

In the Revised Scheme of Education and Training, the concept of electives is being introduced at the Final level in line with the school of thought that specialisation is the key to developing professionally competent chartered accountants. As per this school of thought, an emerging chartered accountant has to be geared up to assume new roles as consultants and advisors, necessitated on account of growing business complexity, dynamic changes in legislations and regulatory requirements and client expectations.

The seven core papers, namely, Financial Reporting, Strategic Financial Management, Advanced Auditing and Professional Ethics, Corporate and Economic Laws, Strategic Cost Management and Performance Evaluation, Direct Tax Laws and Indirect Tax Laws, represent the competence areas in respect of which an aspiring chartered accountant has to be technically well equipped, regardless of his intended future specialization or role. These subjects, in fact, provide the base to enable an aspiring chartered accountant to specialize in any professional accounting role. For instance, the core paper on direct tax laws and international taxation lays the foundation for further specialisation in the area of international taxation. Further, consequent to borderless economies, it has become imperative that subjects which transcend the borders be added in the curriculum, for instance, Global Financial Reporting Standards and International Taxation.

The six elective papers introduced in the Revised Scheme are Risk Management, Financial Services and Capital Markets, International Taxation, Economic Laws, Global Financial Reporting Standards and Multi-disciplinary case study. Students have to opt for one out of these six papers keeping in mind their desired area of specialization.

Framework and brief introduction of Chapters

The Part B of the Elective Paper 6B – Financial Services and Capital Markets consists of SEBI Regulations (excluding Schedules) as mentioned in detailed contents of this part and it is applicable for May 2020 Examination.

The applicable five Regulations are enumerated as below:

- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
- SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015
- SEBI (Prohibition of Insider Trading) Regulations, 2015
- SEBI (Buy Back of Securities) Regulations, 2018
- SEBI (Mutual Funds) Regulations, 1996

Further, though reference to Schedules has been given in the Regulations, the students are advised to go through it for understanding purpose only. However, schedules are specifically excluded while preparing the text of the Regulations as given in this part of the Study Material.

Since, regulations as given in Part B have been extracted from the regulations being hosted at SEBI website, inadvertent inclusion/ exclusion is possible. Therefore, in case of any doubt or difficulty, the students are advised to contact Board of Studies at the contact details given at the end.

Strategy to approach this study material

It is desired from the students that they cover the entire syllabus and also required to visit ICAI Website for additional study material in the form of Supplementary material, etc. Students are also advised to update themselves with the latest changes in the financial sector. Students are, therefore, required to refer to academic updates in 'Students Journal' published by the Board of Studies, the monthly journal 'The Chartered Accountant', financial newspapers such as Economic Times, Mint, Business Line and Business Standard and SEBI Circulars relating to five Regulations as mentioned above.

This Part of Study Material has to be referred in conjunction with Part A of the Study Material. Please note that while Part A may be revised, if required, Part B will be revised on yearly basis. Hence, it is essential that students should refer the applicable edition of Part B of Study Material as per the announcement being hosted at ICAI Website on time to time basis.

Although, sincere efforts have been made to keep the study material error free yet, it may so happen that errors if any, may inadvertently crept in. In this respect, students are encouraged to highlight any mistake they may notice while going through the study material by sending an e-mail at fscm-final@icai.in or write to the Director of Studies, The Institute of Chartered Accountants of India, A-29, Sector-62, Noida-201309.

Happy Reading and Best Wishes!

CONTENTS

DETAILED CONTENTS: PART B

1. SEBI (ICDR) REGULATIONS, 2018

2. SEBI (LODR) REGULATIONS, 2015

CHAPTER 1

SEBI (ICDR) REGULATIONS, 2018

CHAPTER I

PRELIMINARY

Short title and commencement

1.(1) These regulations may be called the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

(2) They shall come into force on the sixtieth day from the date of its publication in the Official Gazette.

Definitions

2. (1) In these regulations, unless the context otherwise requires:

(a)"Act" means the Securities and Exchange Board of India Act, 1992 [15 of1992];

(b)"advertisement" includes notices, brochures, pamphlets, show cards, catalogues, hoardings, placards, posters, insertions in newspaper, pictures and films in any print media or electronic media, radio, television programme;

(c)"anchor investor" means a qualified institutional buyer who makes an application for a value of at least ten crore rupees in a public issue on the main board made through the book building process in accordance with these regulations or makes an application for a value of at least two crore rupees for an issue made in accordance with Chapter IX of these regulations;

(d)"application supported by blocked amount (ASBA)" means an application for subscribing to a public issue or rights issue, along with an authorisation to self-certified syndicate bank to block the application money in a bank account;

(e) "associate" means a person which is an associate of the issuer and as defined under the Companies Act,2013;

(f) "Board" means the Securities and Exchange Board of India established under the Act;

(g) "book building" means a process undertaken to elicit demand and to assess the price for determination of the quantum or value or coupon of specified securities or Indian Depository Receipts, as the case may be, in accordance with these regulations;

(h) "composite issue" means an issue of specified securities by a listed issuer on public-cum-rights basis, wherein the allotment in both public issue and rights issue is proposed to be made simultaneously;

(i) "control" shall have the same meaning as assigned to it under the Securities and Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulations,2011;

(j) "convertible debt instrument" means an instrument which creates or acknowledges indebtedness and is convertible into equity shares of the issuer at a later date at or without the option of the holder of the instrument, whether constituting a charge on the assets of the issuer or not;

(k) "convertible security" means a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of such security and includes convertible debt instrument and convertible preference shares;

(l) "designated stock exchange" means a recognised stock exchange having nationwide trading terminals chosen by the issuer on which securities of an issuer are listed or proposed to be listed for the purpose of a particular issue of specified securities under these regulations:

Provided that, the issuer may choose a different recognised stock exchange as a designated stock exchange for any subsequent issue of specified securities;

(m) "draft letter of offer" means the draft letter of offer filed with the Board in relation to a rights issue under these regulations;

(n) "draft offer document" means the draft offer document filed with the Board in relation to a public issue under these regulations;

(o) "employee" means a permanent employee, working in India or outside India, of the issuer or of the promoters or subsidiary company of the issuer, or a director of the issuer, whether whole-time or not and does not include (i) promoters, (ii) a person belonging to the promoter group; or (iii) a director who either himself/herself or through their relatives or through any body corporate, directly or indirectly, holds more than ten per cent. of the outstanding equity shares of the issuer;

Provided that for the purposes of stock option schemes, employee shall have the same meaning as assigned to under the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014;

(p) "fugitive economic offender" shall mean an individual who is declared a fugitive economic offender under section 12 of the Fugitive Economic Offenders Act, 2018 (17 of 2018);

(q) "further public offer" means an offer of specified securities by a listed issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holders of such specified securities in a listed issuer;

(r) "general corporate purposes" include such identified purposes for which no specific amount is allocated or any amount so specified towards general corporate purpose or any such purpose by whatever name called, in the draft offer document, draft letter of offer, or the offer document:

Provided that any issue related expenses shall not be considered as a part of general corporate purpose merely because no specific amount has been allocated for such expenses in the draft offer document, draft letter of offer or the offer document;

(s) "green shoe option" means an option of allotting equity shares in excess of the equity shares offered in the public issue as a post-listing price stabilizing mechanism;

(t)"group companies", shall include such companies (other than promoter(s) and subsidiary/subsidiaries) with which there were related party transactions, during the period for which financial information is disclosed, as covered under the applicable accounting standards, and also other companies as considered material by the board of the issuer;

(u)"housing finance company" means a deposit taking housing finance company registered with the National Housing Bank for carrying on the business of housing finance;

(v) "infrastructure sector" shall include the following facilities/services:

i) transportation (including inter modal transportation), including the following:

A) roads, national highways, state highways, major district roads, other district roads and village roads, including toll roads, bridges, highways, road transport providers and other road-related services;

B) rail system, rail transport providers, metro rail roads and other railway related services;

C) ports (including minor ports and harbours), inland waterways, coastal shipping including shipping lines and other port related services;

D) aviation, including airports, heliports, airlines and other airport related services;

E) logistics services;

ii) agriculture, including the following:

A) infrastructure related to storage facilities;

B) construction relating to projects involving agro-processing and supply of inputs to agriculture;

C) construction for preservation and storage of processed agro-products, perishable goods such as fruits, vegetables and flowers including testing facilities for quality;

iii) water management, including the following:

A) water supply or distribution;

B) irrigation;

C) water treatment ,etc.

iv) telecommunication, including the following:

A) basic or cellular, including radio paging;

B) domestic satellite service (i.e., satellite owned and operated by an Indian company for providing telecommunication service);

C) network of trunking, broadband network and internet services;

v) industrial, commercial and social development and maintenance, including the following:

A) real estate development, including an industrial park or special economic zone;

B) tourism, including hotels, convention centres and entertainment centres;

C) public markets and buildings, trade fair, convention, exhibition, cultural centres, sports and recreation infrastructure, public gardens and parks;

D) construction of educational institutions and hospitals;

E) other urban development, including solid waste management systems, sanitation and sewerage systems, etc.;

vi) power, including the following:

A) generation of power through thermal, hydro, nuclear, fossil fuel, wind and other renewable sources;

B) transmission, distribution or trading of power by laying a network of new transmission or distribution lines;

vii) petroleum and natural gas, including the following:

A) exploration and production;

B) import terminals;

C) liquefaction and re-gasification;

D) storage terminals;

E) transmission networks and distribution networks including city gas infrastructure;

viii) housing, including the following:

A) urban and rural housing including public or mass housing, slum rehabilitation etc;

B) other allied activities such as drainage, lighting, laying of roads, sanitation

ix) services provided by recognised stock exchanges and registered depositories, in relation to securities;

x) other miscellaneous facilities or services, including the following:

A) mining and related activities;

B) technology related infrastructure;

C) manufacturing of components and materials or any other utilities or facilities required by the infrastructure sector like energy saving devices and metering devices, etc.;

D) environment related infrastructure;

E) disaster management services;

F) preservation of monuments and icons;

G) emergency services (including medical, police, fire, and rescue);

xi) such other facility or service which, in the opinion of the board, constitutes infrastructure sector;

(w) "initial public offer" means an offer of specified securities by an unlisted issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holders of such specified securities in an unlisted issuer;

(x) "innovators growth platform" means the trading platform for listing and trading of specified securities of issuers that comply with the eligibility criteria specified in regulation 283;

(y) "institutional investor" means (i) qualified institutional buyer; or (ii) family trust or intermediaries registered with the Board, with net worth of more than five hundred crore rupees, as per the last audited financial statements, for the purposes of listing and/or trading on innovators growth platform] in terms of Chapter X;

(z) "issue size" includes offer through offer document and promoters' contribution brought in as part of the issue;

(aa) "issuer" means a company or a body corporate authorized to issue specified securities under the relevant laws and whose specified securities are being issued and/or offered for sale in accordance with these regulations;

(bb) "key managerial personnel" means the officers or personnel of the issuer who are members of its core management team (excluding board of directors) and includes members of the management one level below the executive directors of the issuer, functional heads and ‘key managerial personnel’ as defined under the Companies Act, 2013 or any other person whom the issuer may declare as a key managerial personnel;

(cc) “lead manager” means a merchant banker registered with the Board and appointed by the issuer to manage the issue and in case of a book built issue, the lead manager(s) appointed by the issuer shall act as the book running lead manager(s) for the purposes of book building;

(dd) “listed issuer” means an issuer whose equity shares are listed on a recognised stock exchange having nationwide trading terminals;

(ee) “main board” means a recognised stock exchange having nationwide trading terminals, other than SME exchange;

(ff) “net offer” means an offer of specified securities to the public but does not include reservations and promoters’ contribution brought in as part of the issue;

(gg) “net tangible assets” mean the sum of all net assets of the issuer, excluding intangible assets as defined in Accounting Standard 26 (AS 26) or Indian Accounting Standard (Ind AS) 38, as applicable, issued by the Institute of Chartered Accountants of India;

(hh) “net worth” means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account and debit or credit balance of profit and loss account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

(ii) “nominated investor” means a qualified institutional buyer or private equity fund, whoenters into an agreement with the lead manager(s) to subscribe to an issue, made in accordance with Chapter IX, in case of under-subscription or to receive or deliver the specified securities in the market-making process in such an issue;

Explanation: “private equity fund” means a fund registered with any regulatory authority or a

fund established by any person registered with any regulatory authority;

(jj) “non-institutional investor” means an investor other than a retail individual investor and qualified institutional buyer;

(kk) “offer document” means a red herring prospectus, prospectus or shelf prospectus, as applicable, referred to under the Companies Act, 2013, in case of a public issue, and a letter of offer in case of a rights issue;

(ll) “offer through offer document” means net offer and reservations;

(mm)"persons acting in concert" shall have the same meaning as assigned to it under regulation 2(1)(q) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

(nn) "preferential issue" means an issue of specified securities by a listed issuer to any select person or group of persons on a private placement basis in accordance with Chapter V of these regulations and does not include an offer of specified securities made through employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities;

(oo) "promoter" shall include a person:

(i) who has been named as such in a draft offer document or offer document or is identified by the issuer in the annual return referred to in section 92 of the Companies Act, 2013; or

(ii) who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise; or

(iii) in accordance with whose advice, directions or instructions the board of directors of the issuer is accustomed to act:

Provided that nothing in sub-clause (iii) shall apply to a person who is acting merely in a professional capacity;

Provided further that a financial institution, scheduled commercial bank, foreign investor other than Category III foreign portfolio investor, mutual fund, venture capital fund, alternative investment fund, foreign venture capital investor, insurance company registered with the Insurance Regulatory and Development Authority of India or any other category as specified by the Board from time to time, shall not be deemed to be a promoter merely by virtue of the fact that twenty per cent. or more of the equity share capital of the issuer is held by such person unless such person satisfy other requirements prescribed under these regulations;

(pp) "promoter group" includes:

i) the promoter;

ii) an immediate relative of the promoter (i.e. any spouse of that person, or any parent, brother, sister or child of the person or of the spouse);and

iii) in case promoter is a body corporate:

A) a subsidiary or holding company of such body corporate;

B) anybody corporate in which the promoter holds twenty per cent. or more of the equity share capital; and/or anybody corporate which holds twenty per cent. or more of the equity share capital of the promoter;

C) anybody corporate in which a group of individuals or companies or combinations thereof acting in concert, which hold twenty per cent. or more of the equity share capital in that body corporate and such group of individuals or companies or combinations thereof also holds twenty per cent. or more of the equity share capital of the issuer and are also acting in concert; and

iv) in case the promoter is an individual:

A) anybody corporate in which twenty per cent. or more of the equity share capital is held by the promoter or an immediate relative of the promoter or a firm or Hindu Undivided Family in which the promoter or any one or more of their relative is a member;

B) anybody corporate in which a body corporate as provided in (A) above holds twenty per cent. or more, of the equity share capital; and

C) any Hindu Undivided Family or firm in which the aggregate share of the promoter and their relatives is equal to or more than twenty per cent. of the total capital;

v) all persons whose shareholding is aggregated under the heading "shareholding of the promoter group":

Provided that a financial institution, scheduled bank, foreign portfolio investor other than Category III foreign portfolio investor, mutual fund, venture capital fund, alternative investment fund, foreign venture capital investor, insurance company registered with the Insurance Regulatory and Development Authority of India or any other category as specified by the Board from time to time, shall not be deemed to be promoter group merely by virtue of the fact that twenty per cent. or more of the equity share capital of the promoter is held by such person or entity:

Provided further that such financial institution, scheduled bank, foreign portfolio investor other than Category III foreign portfolio investor, mutual fund, venture capital fund, alternative investment fund and foreign venture capital investor insurance company registered with the Insurance Regulatory and Development Authority of India or any other category as specified by the Board from time to time shall be treated as promoter group for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them;

(qq) "public financial institution" means a public financial institution as defined under the Companies Act, 2013;

(rr) "public issue" means an initial public offer or a further public offer;

(ss) "qualified institutional buyer" means:

i) a mutual fund, venture capital fund, alternative investment fund and foreign venture capital investor registered with the Board;

ii) a foreign portfolio investor other than Category III foreign portfolio investor, registered with the Board;

iii) a public financial institution;

iv) a scheduled commercial bank;

v) a multilateral and bilateral development financial institution;

vi) a state industrial development corporation;

vii) an insurance company registered with the Insurance Regulatory and Development Authority of India;

viii) a provident fund with minimum corpus of twenty five crore rupees;

ix) a pension fund with minimum corpus of twenty five crore rupees;

x) National Investment Fund set up by resolution no. F. No. 2/3/2005-DDII dated November 23, 2005 of the Government of India published in the Gazette of India;

xi) insurance funds set up and managed by army, navy or air force of the Union of India; and

xii) insurance funds set up and managed by the Department of Posts, India; and

xiii) systemically important non-banking financial companies.

(tt) "qualified institutions placement" means issue of eligible securities by a listed issuer to qualified institutional buyers on a private placement basis and includes an offer for sale of specified securities by the promoters and/or promoter group on a private placement basis, in terms of these regulations;

(uu) "relative" means a relative as defined under the Companies Act, 2013.

(vv) "retail individual investor" means an individual investor who applies or bids for specified securities for a value of not more than two lakhs rupees;

(ww) "retail individual shareholder" means a shareholder who applies or bids for specified securities for a value of not more than two lakhs rupees;

(xx) "rights issue" means an offer of specified securities by a listed issuer to the shareholders of the issuer as on the record date fixed for the said purpose;

(yy) "schedule" means schedule annexed to these regulations;

(zz) "scheduled commercial bank" means scheduled commercial banks as included in the second schedule to the Reserve Bank of India Act, 1934;

(aaa) “self-certified syndicate bank” means a banker to an issue registered with the Board, which offers the facility of ASBA;

(bbb)“selling shareholder(s)” means any shareholder of the issuer who is offering for sale the specified securities in a public issue in accordance with these Regulations;

(ccc)“securities laws” means the Act, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made there under and the general or special orders, guidelines or circulars made or issued by the Board there under and the provisions of the Companies Act, 2013 or any previous company law and any subordinate legislation framed there under, which are administered by the Board ;

(ddd)“SME exchange” means a trading platform of a recognised stock exchange having nationwide trading terminals permitted by the Board to list the specified securities issued in accordance with Chapter IX and includes a stock exchange granted recognition for this purpose but does not include the Main Board;

(eee) “specified securities" means equity shares and convertible securities;

(fff)“stabilising agent” means a merchant banker who is responsible for stabilising the price of equity shares under a green shoe option, in terms of these regulations;

(ggg)“stock exchange” means any recognised stock exchange having nationwide trading terminals chosen by the issuer on which securities of an issuer are listed or proposed to be listed for the purpose of a particular issue of specified securities under these regulations, other than an SMEexchange;

(hhh)“syndicate member” means an intermediary registered with the Board and who is permitted to accept bids, applications and place orders with respect to the issue and carry on the activity as an under writer;

(iii)“systemically important non-banking financial companies” means a non-banking financial company registered with the Reserve Bank of India and recognised as systemically important non-banking financial company by the Reserve Bank of India;

(jjj)“unlisted issuer” means an issuer which is not a listed issuer;

(kkk)“valuer” means a person who is registered under section 247 of the Companies Act, 2013 and the relevant rules framed there under or as specified by the Board;

(lll)“wilful defaulter” means a person or an issuer who or which is categorized as a wilful defaulter by any bank or financial institution (as defined under the Companies Act, 2013) or consortium thereof, in accordance with the guidelines on wilful defaulters issued by the Reserve Bank of India;

(mmm) “working day” means all days on which commercial banks in the city as specified in the offer document are open for business;

Explanation: For the purpose of this clause, in respect of –

(a) announcement of price band; and

(b) bid/issue period, working day shall mean all days, excluding Saturdays, Sundays and public holidays, on which commercial banks in the city as notified in the offer document are open for business;

(c) the time period between the bid/ issue closing date and the listing of the specified securities on the stock exchanges, working day shall mean all trading days of the stock exchanges, excluding Sundays and bank holidays, as per circulars issued by the Board.

(2) All other words and expressions used but not defined in these regulations, but defined in the Act or the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and/or the rules and regulations made there under shall have the same meaning as respectively assigned to them in such statutes or rules or regulations or any statutory modification or re-enactment thereto, as the case may be.

Applicability of the regulations

3. Unless otherwise provided, these regulations shall apply to the following:

(a) an initial public offer by an unlisted issuer;

(b) a rights issue by a listed issuer; where the aggregate value of the issue is ten crore rupees or more;

(c) a further public offer by a listed issuer;

(d) a preferential issue by a listed issuer;

(e) a qualified institutions placement by a listed issuer;

(f) an initial public offer of Indian depository receipts;

(g) a rights issue of Indian depository receipts;

(h) an initial public offer by a small and medium enterprise;

(i) a listing on the innovators growth platform through an issue or without an issue; and

(j) a bonus issue by a listed issuer.

Provided that in case of rights issue of size less than ten crore rupees, the issuer shall prepare the letter of offer in accordance with requirements as specified in these regulations and file the same with the Board for information and dissemination on the Board’s website.

Provided further that these regulations shall not apply to issue of securities under clause (b), (d) and (e) of sub-regulation (1) of regulation 9 of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

CHAPTER II

INITIAL PUBLIC OFFER ON MAIN BOARD

PART I: ELIGIBILITY REQUIREMENTS

Reference date

4. Unless otherwise provided in this Chapter, an issuer making an initial public offer of specified securities satisfy the conditions of this Chapter as on the date of filing of the draft offer document with the Board and also as on the date of registering the offer document with the Registrar of Companies.

Entities not eligible to make an initial public offer

5. (1) An issuer shall not be eligible to make an initial public offer-

a. if the issuer, any of its promoters, promoter group or directors or selling shareholders are debarred from accessing the capital market by the Board.

b. if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board.

c. if the issuer or any of its promoters or directors is a willful defaulter.

d. if any of its promoters or directors is a fugitive economic offender.

Explanation: The restrictions under (a) and (b) above shall not apply to the persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft offer document with the Board.

(2) An issuer shall not be eligible to make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares of the issuer:

Provided that the provisions of this sub-regulation shall not apply to:

(a) outstanding options granted to employees, whether currently an employee or not, pursuant to an employee stock option scheme in compliance with the Companies Act, 2013, the relevant Guidance Note or accounting standards, if any, issued by the Institute of Chartered Accountants of India or pursuant to the Companies Act, 2013, in this regard;

(b) fully paid-up outstanding convertible securities which are required to be converted on or before the date of filing of the red herring prospectus (in case of book-built issues) or the prospectus (in case of fixed price issues), as the case maybe.

0Eligibility requirements for an initial public offer

6. (1) An issuer shall be eligible to make an initial public offer only if:

(a) it has net tangible assets of at least three crore rupees, calculated on a restated and consolidated basis, in each of the preceding three full years (of twelve months each), of which not more than fifty per cent. are held in monetary assets:

Provided that if more than fifty per cent of the net tangible assets are held in monetary assets, the issuer has utilised or made firm commitments to utilise such excess monetary assets in its business or project;

Provided further that the limit of fifty per cent on monetary assets shall not be applicable in case the initial public offer is made entirely through an offer for sale.

(b) it has an average operating profit of at least fifteen crore rupees, calculated on a restated and consolidated basis, during the preceding three years (of twelve months each), with operating profit in each of these preceding three years;

(c) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each), calculated on a restated and consolidated basis;

(d) if it has changed its name within the last one year, at least fifty per cent. of the revenue, calculated on a restated and consolidated basis, for the preceding one full year has been earned by it from the activity indicated by its new name.

(2) An issuer not satisfying the condition stipulated in sub-regulation (1) shall be eligible to make an initial public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent. of the net offer to qualified institutional buyers and to refund the full subscription money if it fails to do so.

General conditions

7. (1) An issuer making an initial public offer shall ensure that:

(a) it has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of **Schedule XIX;**

(b) it has entered into an agreement with a depository for dematerialisation of the specified securities already issued and proposed to be issued;

(c) all its specified securities held by the promoters are in dematerialised form prior to filing of the Offer document;

(d) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

(e) it has made firm arrangements of finance through verifiable means towards seventy five per cent. of the stated means of finance for a specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

(2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document shall not exceed twenty five per cent. of the amount being raised by the issuer.

Explanation: For the purposes of this regulation:

(I) "project" means the object for which monies are proposed to be raised to cover the objects of the issue;

(II) In case of an issuer which had been a partnership firm or a limited liability partnership, the track record of operating profit of the partnership firm or the limited liability partnership shall be considered only if the financial statements of the partnership business for the period during which the issuer was a partnership firm or a limited liability partnership, conform to and are revised in the format prescribed for companies under the Companies Act, 2013 and also comply with the following:

(a) adequate disclosures are made in the financial statements as required to be made by the issuer as per schedule III of the Companies Act,2013;

(b) the financial statements are duly certified by the statutory auditor stating that:

(i) the accounts and the disclosures made are in accordance with the provisions of schedule III of the Companies Act,2013;

(ii) the applicable accounting standards have been followed;

(iii) the financial statements present a true and fair view of the firm's accounts;

(III) In case of an issuer formed out of a division of an existing company, the track record of distributable profits of the division spun-off shall be considered only if the requirements regarding financial statements as provided for partnership firms or limited liability partnerships in Explanation (II) are complied with.

Additional conditions for an offer for sale

8. Only such fully paid-up equity shares may be offered for sale to the public, which have been held by the sellers for a period of at least one year prior to the filing of the draft offer document:

Provided that in case the equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities, including depository receipts, as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period referred in this sub-regulation.

Provided further that such holding period of one year shall be required to be complied with at the time of filing of the draft offer document.

Explanation: If the equity shares arising out of the conversion or exchange of the fully paid-up compulsorily convertible securities are being offered for sale, the conversion or exchange should be completed prior to filing of the offer document (i.e. red herring prospectus in the case of a book built issue and prospectus in the case of a fixed price issue), provided full disclosures of the terms of conversion or exchange are made in the draft offer document.

Provided further that the requirement of holding equity shares for a period of one year shall not apply:

a) in case of an offer for sale of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in the infrastructure sector;

b) if the equity shares offered for sale were acquired pursuant to any scheme approved by a High Court under the sections 391 to 394 of Companies Act, 1956, or approved by a tribunal or the Central Government under the sections 230 to 234 of Companies Act, 2013, as applicable, in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme;

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

(i) such specified securities being issued out of free reserves and share premium existing in the books of account as at the end of the financial year preceding the financial year in which the draft offer document is filed with the Board; and.

(ii) such equity shares not being issued by utilisation of revaluation reserves or unrealized profits of the issuer.

PART II: ISSUE OF CONVERTIBLE DEBT INSTRUMENTS AND WARRANTS

Eligibility requirements for issue of convertible debt instruments

9. An issuer shall be eligible to make an initial public offer of convertible debt instruments even without making a prior public issue of its equity shares and listing thereof.

Provided that it is not in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months.

Additional requirements for issue of convertible debt instruments

10. (1) In addition to other requirements laid down in these regulations, an issuer making an initial public offer of convertible debt instruments shall also comply with the following conditions:

(a) it has obtained credit rating from at least one credit rating agency;

(b) it has appointed at least one debenture trustee in accordance with the provisions of the Companies Act, 2013 and the Securities and Exchange Board of India (Debenture Trustees) Regulations,1993;

(c) it shall create a debenture redemption reserve in accordance with the provisions of the Companies Act, 2013 and rules made there under;

(d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:

(i) such assets are sufficient to discharge the principal amount at all times;

(ii) such assets are free from any encumbrance;

(iii) where security is already created on such assets in favour of any existing lender or security trustee or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such lender or security trustee or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;

(iv) the security or asset cover shall be arrived at after reduction of the liabilities having a first or prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

(2) The issuer shall redeem the convertible debt instruments in terms of the offer document.

Conversion of optionally convertible debt instruments into equity shares

11. (1) The issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any listed convertible debt instruments issued by an issuer exceeds ten crore rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares:

Provided that where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

(4) The provision of sub-regulation (2) shall not apply if such redemption is as per the disclosures made in the offer document.

Issue of convertible debt instruments for financing

12. An issuer shall not issue convertible debt instruments for financing or for providing loans to or for acquiring shares of any person who is part of the promoter group or group companies:

Provided that an issuer shall be eligible to issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Issue of warrants

13. An issuer shall be eligible to issue warrants in an initial public offer subject to the following:

a) the tenure of such warrants shall not exceed eighteen months from the date of their allotment in the initial public offer;

b) a specified security may have one or more warrants attached to it;

c) the price or formula for determination of exercise price of the warrants shall be determined upfront and disclosed in the offer document and at least twenty-five per cent. of the consideration amount based on the exercise price shall also be received upfront;

Provided that in case the exercise price of warrants is based on a formula, twenty-five per cent consideration amount based on the cap price of the price band determined for the linked equity shares or convertible securities shall be received upfront.

d) in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within three months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

PART III: PROMOTERS' CONTRIBUTION

Minimum promoters' contribution

14. (1) The promoters of the issuer shall hold at least twenty per cent. of the post-issue capital:

Provided that in case the post-issue shareholding of the promoters is less than twenty per cent., alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India may contribute to meet the shortfall in minimum contribution as specified for the promoters, subject to a maximum of ten per cent. of the post-issue capital without being identified as promoter(s).

Provided further that the requirement of minimum promoters' contribution shall not apply in case an issuer does not have any identifiable promoter

(2) The minimum promoters' contribution shall be as follows:

a) the promoters shall contribute twenty per cent. as stipulated in sub-regulation (1), as the case may be, either by way of equity shares or by way of subscription to convertible securities:

Provided that if the price of the equity shares allotted pursuant to conversion is not pre-determined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public issue and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities.

b) in case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre-determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities.

c) subject to the provisions of clause (a) and (b) above, in case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters shall bring in a contribution of at least twenty per cent. of the project cost in the form of equity shares, subject to contributing at least twenty per cent. of the issue size from their own funds in the form of equity shares:

Provided that if the project is to be implemented in stages, the promoters' contribution shall be with respect to total equity participation till the respective stage vis-à-vis the debt raised or proposed to be raised through the public issue.

(3) The promoters shall satisfy the requirements of this regulation at least one day prior to the date of opening of the issue.

(4) In case the promoters have to subscribe to equity shares or convertible securities towards minimum promoters' contribution, the amount of promoters' contribution shall be kept in an escrow account with a scheduled commercial bank, which shall be released to the issuer along with the release of the issue proceeds:

Provided that where the promoters' contribution has already been brought in and utilised, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document;

Provided further that where the minimum promoters' contribution is more than one hundred crore rupees and the initial public offer is for partly paid shares, the promoters shall bring in at least one hundred crore rupees before the date of opening of the issue and the remaining amount may be brought on a pro-rata basis before the calls are made to the public.

Explanation: For the purpose of this regulation:

(I) Promoters' contribution shall be computed on the basis of the post-issue expanded capital:

a) assuming full proposed conversion of convertible securities into equity shares;

b) assuming exercise of all vested options, where any employee stock options are outstanding at the time of initial public offer in terms of proviso (a)to sub-regulation (2) of regulation 5.

(II) For computation of "weighted average price":

a) "weight" means the number of equity shares arising out of conversion of such specified securities into equity shares at various stages;

b) "price" means the price of equity shares on conversion arrived at after taking into account the predetermined conversion price at various stages.

Securities ineligible for minimum promoters' contribution

15. (1) For the computation of minimum promoters' contribution, the following specified securities shall not be eligible:

(a) specified securities acquired during the preceding three years, if these are:

i. acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or

ii. resulting from a bonus issue by utilisation of revaluation reserves or unrealized profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters' contribution;

(b) specified securities acquired by the promoters and alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India, during the preceding one year at a price lower than the price at which specified securities are being offered to the public in the initial public offer:

Provided that nothing contained in this clause shall apply:

(i) if the promoters and alternative investment funds, as applicable, pay to the issuer the difference between the price at which the specified securities are offered in the initial public offer and the price at which the specified securities had been acquired;

(ii) if such specified securities are acquired in terms of the scheme under sections 391 to 394 of the Companies Act, 1956 or sections 230 to 234 of the Companies Act, 2013, as approved by a High Court or a tribunal or the Central Government, as applicable, by the promoters in lieu of business and invested capital that had been in existence for a period of more than one year prior to such approval; to an initial public offer by a government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in the infrastructure sector;

(c) specified securities allotted to the promoters and alternative investment funds during the preceding one year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms or limited liability partnerships, where the partners of the erstwhile partnership firms or limited liability partnerships are the promoters of the issuer and there is no change in the management:

Provided that specified securities, allotted to the promoters against the capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible;

(d) specified securities pledged with any creditor.

(2) Specified securities referred to in clauses (a) and (c) of sub-regulation (1) shall be eligible for the computation of promoters' contribution if such securities are acquired pursuant to a scheme which has been approved by a High Court under the sections 391 to 394 of the Companies Act, 1956 or approved by a tribunal or the Central Government under sections 230 to 234 of the Companies Act, 2013.

PART IV: LOCK-IN AND RESTRICTIONS ON TRANSFERABILITY

Lock-in of specified securities held by the promoters

16. The specified securities held by the promoters shall not be transferable (hereinafter referred to as "lock- in") for the periods as stipulated here under:

(a) minimum promoters' contribution including contribution made by alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India referred to in proviso to sub-regulation (1) of regulation 14, shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the initial public offer, whichever is later;

(b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year from the date of allotment in the initial public offer.

Explanation: For the purposes of this clause, the expression "date of commencement of commercial production" means the last date of the month in which commercial production of the project in respect of which the funds raised are proposed to be utilised as stated in the offer document, is expected to commence.

Lock-in of specified securities held by persons other than the promoters

17. The entire pre-issue capital held by persons other than the promoters shall be locked-in for a period of one year from the date of allotment in the initial public offer:

Provided that nothing contained in this regulation shall apply to:

a) equity shares allotted to employees, whether currently an employee or not, under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme in accordance with **Part A** of **Schedule VI**;

b) equity shares held by an employee stock option trust or transferred to the employees by an employee stock option trust pursuant to exercise of options by the employees, whether currently employees or not, in accordance with the employee stock option plan or employee stock purchase scheme.

Provided that the equity shares allotted to the employees shall be subject to the provisions of lock-in as specified under the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014.

c) equity shares held by a venture capital fund or alternative investment fund of category I or Category II or a foreign venture capital investor:

Provided that such equity shares shall be locked in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

Explanation: For the purpose of clause (c), in case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period and convertible securities shall be deemed to be fully paid-up, if the entire consideration payable thereon has been paid and no further consideration is payable at the time of their conversion.

Lock-in of specified securities lent to stabilising agent under the green shoe option

18. The lock-in provisions shall not apply with respect to the specified securities lent to stabilising agent for the purpose of green shoe option, during the period starting from the date of lending of such specified securities and ending on the date on which they are returned to the lender in terms of sub-regulation (5) or (6) of regulation 57:

Provided that the specified securities shall be locked-in for the remaining period from the date on which they are returned to the lender.

Lock-in of partly-paid securities

19. If the specified securities which are subject to lock-in are partly paid-up and the amount called-upon such specified securities is less than the amount called-upon the specified securities issued to the public, the lock-in shall end only on the expiry of three years after such specified securities have become pari passu with the specified securities issued to the public.

Inscription or recording of non-transferability

20. The certificates of specified securities which are subject to lock-in shall contain the inscription "non-transferable" and specify the lock-in period and in case such specified securities are dematerialised, the issuer shall ensure that the lock-in is recorded by the depository.

Pledge of locked-in specified securities

21. Specified securities held by the promoters and locked-in may be pledged as a collateral security for a loan granted by a scheduled commercial bank or a public financial institution or a systemically important non-banking finance company or a housing finance company, subject to the following:

a) if the specified securities are locked-in in terms of clause (a) of regulation 16, the loan has been granted to the issuer company or its subsidiary(ies) for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan;

b) if the specified securities are locked-in in terms of clause (b) of regulation 16 and the pledge of specified securities is one of the terms of sanction of the loan.

Provided that such lock-in shall continue pursuant to the invocation of the pledge and such transferee shall not be eligible to transfer the specified securities till the lock-in period stipulated in these regulations has expired.

Transferability of locked-in specified securities

22. Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 2011, the specified securities held by the promoters and locked-in as per regulation 16, may be transferred to another promoter or any person of the promoter group or a new promoter and the specified securities held by persons other than the promoters and locked-in as per regulation 17, may be transferred to any other person holding the specified securities which are locked-in along with the securities proposed to be transferred:

Provided that the lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

PART V: APPOINTMENT OF LEAD MANAGERS, OTHER INTERMEDIARIES AND COMPLIANCE OFFICER

23. (1) The issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue.

(2) Where the issue is managed by more than one lead manager, the rights, obligations and

responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each lead manager shall be predetermined and be disclosed in the draft offer document and the offer document as specified in **Schedule I**.

(3) At least one lead manager to the issue shall not be an associate (as defined under the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992) of the issuer and if any of the lead manager is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to marketing of the issue.

(4) The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with the Board after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.

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

Provided that such agreements may include such other clauses as the issuer and the intermediaries may deem fit without diminishing or limiting in any way the liabilities and obligations of the lead manager(s), other intermediaries and the issuer under the Act, the Companies Act, 2013 or the Companies Act, 1956 (to the extent applicable), the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made there under or any statutory modification or statutory enactment thereof:

Provided further that in case of ASBA process, the issuer shall take cognisance of the deemed agreement of the issuer with the self-certified syndicate banks.

(6) The issuer shall, in case of an issue made through the book building process, appoint syndicate member(s) and in the case of any other issue, appoint bankers to issue, at centres in the manner specified in **Schedule XII**.

(7) The issuer shall appoint a registrar to the issue, registered with the Board, which has connectivity with all the depositories:

Provided that if the issuer itself is a registrar, it shall not appoint itself as registrar to the issue;

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

(8) The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors ‘grievances.

PART VI: DISCLOSURES IN AND FILING OF OFFER DOCUMENTS

Disclosures in the draft offer document and offer document

24. (1) The draft offer document and offer document shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision.

(2) Without prejudice to the generality of sub-regulation (1), the red-herring prospectus, and prospectus shall contain:

(a) disclosures specified in the Companies Act, 2013 and;

(b) disclosures specified in **Part A** of **Schedule VI** .

(3) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer document.

(4) The lead manager(s) shall call upon the issuer, its promoters and its directors or in case of an offer for sale, also the selling shareholders, to fulfill their obligations as disclosed by them in the draft offer document and the offer document and as required in terms of these regulations.

(5) The lead manager(s) shall ensure that the information contained in the draft offer document and offer document and the particulars as per restated audited financial statements in the offer document are not more than six month sold from the issue opening date.

Filing of the draft offer document and offer document

25. (1) Prior to making an initial public offer, the issuer shall file three copies of the draft offer document with the concerned regional office of the Board under the jurisdiction of which the registered office of the issuer company is located, in accordance with Schedule IV, along with fees as specified in Schedule III, through the lead manager(s).

(2) The lead manager(s) shall submit the following to the Board along with the draft offer document:

a) a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s);

b) a due diligence certificate as per Form A of **Schedule V**;

c) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per Form B of **Schedule V**;

(3) The issuer shall also file the draft offer document with the stock exchange(s) where the specified securities are proposed to be listed, and submit to the stock exchange(s), the Permanent Account Number, bank account number and passport number of its promoters where they are individuals, and Permanent Account Number, bank account number, company registration number or equivalent and the address of the Registrar of Companies with which the promoter is registered, where the promoter is a body corporate.

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

a) the date of receipt of the draft offer document under sub-regulation (1); or

b) the date of receipt of satisfactory reply from the lead manager(s), where the Board has sought any clarification

c) or additional information from them; or the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or

d) the date of receipt of a copy of in-principle approval letter issued by the stock exchange(s).

(5) If the Board specifies any changes or issues observations on the draft offer document, the issuer and lead manager(s) shall carry out such changes in the draft offer document and shall submit to the Board an updated draft offer document complying with the observations issued by the Board and highlighting all changes made in the draft offer document and before registering or filing the offer documents with the Registrar of Companies or an appropriate authority, as applicable.

(6) If there are any changes in the draft offer document in relation to the matters specified in **Schedule XVI**, an updated offer document or a fresh draft offer document, as the case may be, shall be filed with the Board along with fees specified in **Schedule III**.

(7) Copy of the offer documents shall also be filed with the Board and the stock exchange(s) through the lead manager(s) promptly after registering the offer documents with Registrar of Companies.

(8) The draft offer document and the offer document shall also be furnished to the Board in a soft copy.

(9) The lead manager(s) shall submit the following documents to the Board after issuance of observations by the Board or after expiry of the period stipulated in sub-regulation (4) of regulation 25 if the Board has not issued observations:

a) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the offer document;

b) a due diligence certificate as per **Form C** of **Schedule V**, at the time of registering of the offer document;

c) a copy of the resolution passed by the board of directors of the issuer for allotting specified securities to promoter(s) towards amount received against promoters' contribution, before opening of the issue;

d) a certificate from a statutory auditor, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid and credited to the issuer's bank account by each of them towards such contribution;

e) a due diligence certificate as per **Form D** of **Schedule V**, in the event the issuer has made a disclosure of any material development by issuing a public notice pursuant to par 4 of **Schedule** IX.

Draft offer document and offer document to be available to the public

26. (1) The draft offer document filed with the Board shall be made public for comments, if any, for a period of at least twenty one days from the date of filing, by hosting it on the websites of the Board, stock exchanges where specified securities are proposed to be listed and lead manager(s) associated with the issue.

(2) The issuer shall, within two days of filing the draft offer document with the Board, make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing the fact of filing of the draft offer document with the Board and inviting the public to provide their comments to the Board, the issuer or the lead manager(s) in respect of the disclosures made in the draft offer document.

(3) The lead manager(s) shall, after expiry of the period stipulated in sub-regulation (1), file with the Board, details of the comments received by them or the issuer from the public, on the draft offer document, during that period and the consequential changes, if any, that are required to be made in the draft offer document.

(4) The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, Board and the stock exchanges, as applicable.

(5) The lead manager(s) and the stock exchanges shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

PART VII - PRICING

Face value of equity shares

27. The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, advertisements and application forms, along with the price band or the issue price in identical font size.

Pricing

28. (1) The issuer may determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book building process, as the case maybe.

(2) The issuer shall undertake the book building process in the manner specified in Schedule **XIII**.

Price and price band

29. (1) The issuer may mention a price or a price band in the offer document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

(2) The cap on the price band, and the coupon rate in case of convertible debt instruments, shall be less than or equal to one hundred and twenty percent of the floor price.

(3) The floor price or the final price shall not be less than the face value of the specified securities.

(4) Where the issuer opts not to make the disclosure of the floor price or price band in there adhering prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of Schedule X.

(5) The announcement referred to in sub-regulation (4) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" of the offer document.

(6) The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the stock exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the stock exchange(s).

Differential pricing

30. (1) The issuer may offer its specified securities at different prices, subject to the following:

a) retail individual investors or retail individual shareholders or employees entitled for reservation made under regulation 33 may be offered specified securities at a price not lower than by more than ten per cent. of the price at which net offer is made to other categories of applicants, excluding anchor investors;

b) in case of a book built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants;

c) In case the issuer opts for the alternate method of book building in terms of **Part D** of **Schedule XIII**, the issuer may offer the specified securities to its employees at a price not lower than by more than ten per cent. of the floor price.

(2) Discount, if any, shall be expressed in rupee terms in the offer document.

PART VIII: ISSUANCE CONDITIONS AND PROCEDURE

Minimum offer to public

31. The minimum offer to the public shall be subject to the provisions of clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules,1957.

Allocation in the net offer

32. (1) In an issue made through the book building process under sub-regulation (1) of regulation 6 the allocation in the net offer category shall be as follows:

a) Not less than thirty five per cent. to retail individual investors;

b) Not less than fifteen per cent. to non-institutional investors;

c) Not more than fifty per cent. to qualified institutional buyers, five per cent. of which shall be allocated to mutual funds:

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in any other category:

Provided further that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

(2) In an issue made through the book building process under sub-regulation (2) of regulation 6, the allocation in the net offer category shall be as follows:

a) Not more than ten per cent. to retail individual investors;

b) Not more than fifteen per cent. to non-institutional investors;

c) Not less than seventy five percent .to qualified institutional buyers, five percent. of which shall be allocated to mutual funds

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category:

Provided further that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

(3) In an issue made through the book building process, the issuer may allocate up to sixty per cent. of the portion available for allocation to qualified institutional buyers to anchor investors in accordance with the conditions specified in this regard in **Schedule XIII**.

(4) In an issue made other than through the book building process, the allocation in the net offer category shall be made as follows:

i. minimum fifty per cent. to retail individual investors; and

ii. remaining to:

(i) individual applicants other than retail individual investors; and

(ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) maybe allocated to applicants in the other category.

Explanation: For the purpose of sub-regulation (4), if the retail individual investor category is entitled to more than fifty per cent. of the issue size on a proportionate basis, the retail individual investors shall be allocated that higher percentage.

Reservation on a competitive basis

33. (1) The issuer may make reservations on a competitive basis out of the issue size excluding promoters' contribution in favour of the following categories of persons:

a) employees;

b) shareholders (other than promoters and promoter group) of listed subsidiaries or listed promoter companies.

Provided that the issuer shall not make any reservation for the lead manager(s), registrar, syndicate member(s), their promoters, directors and employees and for the group or associate companies (as defined under the Companies Act, 2013) of the lead manager(s), registrar and syndicate member(s) and their promoters, directors and employees.

(2) The reservations on a competitive basis shall be subject to the following conditions:

a) The aggregate of reservations for employees shall not exceed five per cent. of the post-issue capital of the issuer and the value of allotment to any employee shall not exceed two lakhs rupees:

Provided that in the event of under-subscription in the employee reservation portion, the unsubscribed portion may be allotted on a proportionate basis, for a value in excess of two lakhs rupees, subject to the total allotment to an employee not exceeding five lakhs rupees.

b) Reservation for shareholders shall not exceed ten per cent of the issue size;

c) no further application for subscription in the net offer can be made by persons (except an employee and retail individual shareholder) in favour of whom reservation on a competitive basis is made;

d) any unsubscribed portion in any reserved category maybe added to any other reserved category and the unsubscribed portion, if any, after such inter-se adjustments among the reserved categories shall be added to the net offer category;

e) in case of under-subscription in the net offer category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net offer.

(3) An applicant in any reserved category may make an application for any number of specified securities, but not exceeding the reserved portion for that category.

Abridged prospectus

34. (1) The abridged prospectus shall contain the disclosures as specified in **Part E** of **Schedule VI** and shall not contain any matter extraneous to the contents of the offer document.

(2) Every application form distributed by the issuer or any other person in relation to an issue shall be accompanied by a copy of the abridged prospectus.

ASBA

35. The issuer shall accept bids using only the ASBA facility in the manner specified by the Board.

Availability of issue material

36. The lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, and self certified syndicate banks before the opening of the issue.

Prohibition on payment of incentives

37. Any person connected with the issue shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the initial public offer, except for fees or commission for services rendered in relation to the issue.

Security deposit

38. (1) The issuer shall, before the opening of the subscription list, deposit with the designated stock exchange, an amount calculated at the rate of one per cent. of the issue size available for subscription to the public in the manner specified by Board and/or stock exchange(s).

(2) The amount specified in sub-regulation (1) shall be refundable or forfeitable in the manner specified by the Board.

IPO grading

39. The issuer may obtain grading for its initial public offer from one or more credit rating agencies registered with the Board.

Underwriting

40. (1) If the issuer making an initial public offer, other than through the book building process, desires to have the issue underwritten, it shall appoint underwriters in accordance with the Securities and Exchange Board of India (Underwriters) Regulations,1993.

(2) If the issuer makes a public issue through the book building process,

a) the issue shall be underwritten by lead manager(s) and syndicate member(s):

Provided that at least seventy five per cent of the net offer proposed to be compulsorily allotted to qualified institutional buyers for the purpose of compliance of the eligibility conditions specified in sub-regulation (2) of regulation 6, cannot be underwritten.

b) the issuer shall, prior to filing the prospectus, enter into underwriting agreement with the lead manager(s) and syndicate member(s), indicating there in the number of specified securities which they shall subscribe to at the predetermined price in the event of under-subscription in the issue.

c) if the syndicate member(s) fail to fulfil their underwriting obligations, the lead manager(s) shall fulfill the underwriting obligations.

d) the lead manager(s) and syndicate member(s) shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.

e) in case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations,1992.

f) where the issue is required to be underwritten, the underwriting obligations should at least to the extent of minimum subscription.

Monitoring agency

41. (1) If the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by a scheduled commercial bank named in the offer document as bankers of the issuer:

Provided that nothing contained in this clause shall apply to an issue of specified securities made by a bank or public financial institution or an insurance company.

(2) The monitoring agency shall submit its report to the issuer in the format specified in **Schedule XI** on a quarterly basis, till at least ninety five per cent. of the proceeds of the issue, excluding the proceeds raised for general corporate purposes, have been utilized.

(3) The board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency as specified in **Schedule XI**.

(4) The issuer shall, within forty five days from the end of each quarter, publicly disseminate the report of the monitoring agency by uploading the same on its website as well as submitting the same to the stock exchange(s) on which its equity shares are listed.

Public communications, publicity materials, advertisements and research reports

42. All public communication, publicity materials, advertisements and research reports shall comply with the provisions of **Schedule IX**.

Issue-related advertisements

43. (1) Subject to the provisions of the Companies Act, 2013, the issuer shall, after registering the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre-issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

(2) The pre-issue advertisement shall be in the format and shall contain the disclosures specified in **Part A** of **Schedule X**.

Provided that the disclosures in relation to price band or floor price and financial ratios contained therein shall only be applicable where the issuer opts to announce the price band or floor price along with the pre-issue advertisement pursuant to sub-regulation (4) of regulation 29.

(3) The issuer may release advertisements for issue opening and issue closing, which shall be in the formats specified in **Parts B and C** of **Schedule X.**

(4) During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed or indicating investors' response to the issue.

Opening of the issue

44. (1) Subject to the compliance with the provisions of the Companies Act, 2013, a public issue may be opened within twelve months from the date of issuance of the observations by the Board under regulation 25;

(2) An issue shall be opened after at least three working days from the date of registering, the red herring prospectus, in case of a book built issue and the prospectus, in case of a fixed price issue, with the Registrar of Companies.

Minimum subscription

45. (1) The minimum subscription to be received in the issue shall be at least ninety per cent. of the offer through the offer document, except in case of an offer for sale of specified securities:

Provided that the minimum subscription to be received shall be subject to the allotment of minimum number of specified securities, as prescribed under the Securities Contracts (Regulation) Rules,1957.

(2) In the event of non-receipt of minimum subscription referred to in sub-regulation (1), all application monies received shall be refunded to the applicants forthwith, but not later than fifteen days from the closure of the issue**.**

Period of subscription

46. (1) Except as otherwise provided in these regulations, an initial public offer shall be kept open for at least three working days and not more than ten working days.

(2) In case of a revision in the price band, the issuer shall extend the bidding (issue) period disclosed in the red herring prospectus, for a minimum period of three working days, subject to the provisions of sub-regulation (1).

(3) In case of force majeure, banking strike or similar circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding (issue) period disclosed in the red herring prospectus (in case

of a book built issue) or the issue period disclosed in the prospectus (in case of a fixed price issue), for a minimum period of three working days, subject to the provisions of sub-regulation(1).

Application and minimum application value

47. (1) A person shall not make an application in the net offer category for a number of specified securities that exceeds the total number of specified securities offered to the public.

Provided that the maximum application by non-institutional investors shall not exceed total number of specified securities offered in the issue less total number of specified securities offered in the issue to qualified institutional buyers.

(2) The issuer shall stipulate in the offer document the minimum application size in terms of number of specified securities which shall fall within the range of minimum application value of ten thousand rupees to fifteen thousand rupees.

(3) The issuer shall invite applications in multiples of the minimum application value, an illustration whereof is given in **Part B of Schedule XIV**.

(4) The minimum sum payable on application per specified security shall be at least twenty five per cent. of the issue price:

Provided that in case of an offer for sale, the full issue price for each specified security shall be payable at the time of application.

Explanation: For the purpose of this regulation, "minimum application value" shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.

Manner of calls

48. If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrears along with the subscription money already paid on such shares shall be forfeited:

Provided that it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 41.

Allotment procedure and basis of allotment

49. (1) The issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.

(2) The issuer shall not make any allotment in excess of the specified securities offered through the offer document except in case of oversubscription for the purpose of rounding off to make allotment, in consultation with the designated stock exchange.

Provided that in case of oversubscription, an allotment of not more than one per cent.of the net offer to public may be made for the purpose of making allotment in minimum lots.

(3) The allotment of specified securities to applicants other than to the retail individual investors and anchor investors shall be on a proportionate basis within the respective investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed in the offer document:

Provided that the value of specified securities allotted to any person, except in case of employees, in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 33, shall not exceed two lakhs rupees for retail investors or up to five lakhs rupees for eligible employees.

(4) The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to the availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

(5) The authorised employees of the designated stock exchange, along with the lead manager(s) and registrars to the issue, shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the procedure as specified in **Part A of Schedule XIV**.

Allotment, refund and payment of interest

50. (1) The issuer and lead manager(s) shall ensure that the specified securities are allotted and/or application monies are refunded or unblocked within such period as may be specified by the Board.

(2) The lead manager(s) shall ensure that the allotment, credit of dematerialised securities and refund or unblocking of application monies, as may be applicable, are done electronically.

(3) Where the specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated in sub-regulation (1) above, the issuer shall undertake to pay interest at the rate of fifteen per cent. per annum to the investors and within such time as disclosed in the offer document and the lead manager(s) shall ensure the same.

Post-issue advertisements

51. (1) The lead manager(s) shall ensure that an advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the registrar, date of credit of specified securities and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

(2) Details specified in sub regulation (1) shall also be placed on the websites of the stock exchange(s).

Post-issue responsibilities of the lead manager(s)

52. (1) The responsibility of the lead manager(s) shall continue until completion of the issue process and for any issue related matter thereafter.

(2) The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.

(3) The lead manager(s) shall continue to be responsible for post-issue activities till the applicants have received the securities certificates, credit to their demat account or refund of application monies and the listing agreement is entered into by the issuer with the stock exchange and listing or trading permission is obtained.

(4) The lead manager(s) shall be responsible for and co-ordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from syndicate member(s) or collecting bank branches and/ or self-certified syndicate banks, processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, credit of the specified securities to the demat accounts of the allottees and unblocking of ASBA accounts/ despatch of refund orders are completed and securities are listed, as applicable.

(5) Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to the Board.

(6) In case there is a devolvement on the underwriters, the lead manager(s) shall ensure that the notice for devolvement containing the obligation of the underwriters is issued within ten days from the date of closure of the issue.

(7) In the case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to the Board, in the format specified in **Schedule XVIII**.

Release of subscription money

53. (1) The lead manager(s) shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free release the money to the issuer or release the money for refund in case of failure of the issue.

(2) In case the issuer fails to obtain listing or trading permission from the stock exchanges where the specified securities were to be listed, it shall refund through verifiable means the entire monies received within seven days of receipt of intimation from stock exchanges rejecting the application for listing of specified securities, and if any such money is not repaid within eight days after the issuer becomes liable to repay it, the issuer and every director of the company who is an officer in

default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent. per annum.

(3) The lead manager(s) shall ensure that the monies received in respect of the issue are released to the issuer in compliance with the provisions of Section 40 (3) of the Companies Act, 2013, as applicable.

Reporting of transactions of the promoters and promoter group

54. The issuer shall ensure that all transactions in securities by the promoter and promoter group between the date of filing of the draft offer document or offer document, as the case may be, and the date of closure of the issue shall be reported to the stock exchange(s), within twenty four hours of such transactions.

Post-issue reports

55. The lead manager(s) shall submit a final post-issue report as specified in **Part A of Schedule XVII**, along with a due diligence certificate as per the format specified in **Form F** of **Schedule V,** within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure off issue.

PART IX: MISCELLANEOUS

Restriction on further capital issues

56. An issuer shall not make any further issue of specified securities in any manner whether by way of public issue, rights issue, preferential issue, qualified institutions placement, issue of bonus shares or otherwise, except pursuant to an employee stock option scheme, during the period between the

Date of filing the draft offer document and the listing of the specified securities offered through the offer document or refund of application monies, unless full disclosures regarding the total number of specified securities or amount proposed to be raised from such further issue are made in such draft offer document or offer document, as the case maybe.

Price stabilisation through green shoe option

57. (1) An issuer may provide a green shoe option for stabilising the post listing price of its specified securities, subject to the following:

a) the issuer has been authorized, by a resolution passed in the general meeting of shareholders approving the public issue, to allot specified securities to the stabilizing agent, if required, on the expiry of the stabilization period;

b) the issuer has appointed a lead manager as a stabilising agent, who shall be responsible for the price stabilization process;

c) prior to filing the draft offer document, the issuer and the stabilizing agent have entered into an agreement, stating all the terms and conditions relating to the green shoe option including fees charged and expenses to be incurred by the stabilizing agent for discharging its responsibilities;

d) prior to filing the offer document, the stabilising agent has entered into an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them in accordance with clause (g) of this sub-regulation, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size (here in after referred to as the "over-allotment"),which shall not be in excess of fifteen percent of the issue size;

e) subject to clause (d), the lead manager, in consultation with the stabilising agent, shall determine the amount of specified securities to be over-allotted in the public issue;

f) the draft offer document and offer document shall contain all material disclosures about the green shoe option specified in this regard in Part A of **Schedule VI**;

g) in case of an initial public offer pre-issue shareholders and promoters and in case of a further public offer pre-issue shareholders holding more than five per cent. specified securities and promoters, may lend specified securities to the extent of the proposed over-allotment;

h) the specified securities borrowed shall be in dematerialized form and allocation of these securities shall be made pro-rata to all successful applicants.

(2) For the purpose of stabilization of post-listing price of the specified securities, the stabilising agent shall determine the relevant aspects including the timing of buying such securities, quantity to be bought and the price at which such securities are to be bought from the market.

(3) The stabilisation process shall be available for a period not exceeding thirty days from the date on which trading permission is given by the stock exchanges in respect of the specified securities allotted in the public issue.

(4) The stabilizing agent shall open a special account, distinct from the issue account, with a bank for crediting the monies received from the applicants against the over-allotment and a special account with a depository participant for crediting specified securities to be bought from the market during the stabilization period out of the monies credited in the special bank account.

(5) The specified securities bought from the market and credited in the special account with the depository participant shall be returned to the promoters or pre-issue shareholders immediately, in any case not later than two working days after the end of the stabilization period.

(6) On expiry of the stabilisation period, if the stabilising agent has not been able to buy specified securities from the market to the extent of such securities over-allotted, the issuer shall allot specified securities at issue price in dematerialized form to the extent of the shortfall to the special account with the depository participant, within five days of the closure of the stabilization period and such specified securities shall be returned to the promoters or pre-issue shareholders by the stabilizing agent in lieu of the specified securities borrowed from them and the account with the depository participant shall be closed thereafter.

(7) The issuer shall make a listing application in respect of the further specified securities allotted under sub-regulation (6), to all the stock exchanges where the specified securities allotted in the public issue are listed and the provisions of Chapter VII shall not be applicable to such allotment.

(8) The stabilizing agent shall remit the monies with respect to the specified securities allotted under sub-regulation (6) to the issuer from the special bank account.

(9) Any monies left in the special bank account after remittance of monies to the issuer under sub-regulation (8) and deduction of expenses incurred by the stabilising agent for the stabilization process shall be transferred to the Investor Protection and Education Fund established by the Board and the special bank account shall be closed soon thereafter.

(10) The stabilizing agent shall submit a report to the stock exchange on a daily basis during the stabilization period and a final report to the Board in the format specified in Schedule XV.

(11) The stabilizing agent shall maintain a register for a period of at least three years from the date of the end of the stabilization period and such register shall contain the following particulars:

a) The names of the promoters or pre-issue shareholders from whom the specified securities were borrowed and the number of specified securities borrowed from each of them;

b) The price, date and time in respect of each transaction effected in the course of the stabilisation process; and

c) The details of allotment made by the issuer on expiry of the stabilization process.

Alteration of rights of holders of specified securities

58. The issuer shall not alter the terms including the terms of issue of specified securities which may adversely affect the interests of the holders of that specified securities, except with the consent in writing of the holders of not less than three-fourths of the specified securities of that class or with the sanction of a special resolution passed at a meeting of the holders of the specified securities of that class.

Post-listing exit opportunity for dissenting shareholders

59. The promoters, or shareholders in control of an issuer, shall provide an exit offer to dissenting shareholders as provided for in the Companies Act, 2013, in case of change in objects or variation in the terms of contract related to objects referred to in the offer document as per conditions and manner is provided in **Schedule XX**;

Provided that the exit offer shall not apply where there are neither any identifiable promoters nor any shareholders in control of the issuer.

CHAPTER III

RIGHTS ISSUE

PART I: ELIGIBILITY REQUIREMENTS

Reference date

60. Unless otherwise provided in this Chapter, an issuer offering specified securities of aggregate value of ten crore rupees or more, through a rights issue shall satisfy the conditions of this Chapter at the time of filing the draft letter of offer with the Board and also at the time of filing the final letter of offer with the stock exchanges, as the case maybe.

Entities not eligible to make a rights issue

61. An issuer shall not be eligible to make a rights issue of specified securities:

a) if the issuer, any of its promoters, promoter group or directors of the issuer are debarred from accessing the capital market by the Board;

b) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board.

c) if any of its promoters or directors is a fugitive economic offender.

Explanation: The restrictions under (a) and (b) above will not apply to the promoters or directors of the issuer who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft letter of offer with the Board.

General conditions

62. (1) The issuer making a rights issue of specified securities shall ensure that:

a) it has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of **Schedule XIX**.

b) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

c) it has made firm arrangements of finance through verifiable means towards seventy five per cent. of the stated means of finance for the specific project proposed to be funded from issue proceeds, excluding the amount to be raised through the proposed rights issue or through existing identifiable internal accruals.

(2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft letter of offer and the letter of offer, shall not exceed twenty five per cent. of the amount raised by the issuer.

(3) Where the issuer or any of its promoters or directors is a wilful defaulter, the promoters or promoter group of the issuer shall not renounce their rights except to the extent of renunciation within the promoter group.

PART II: ISSUE OF CONVERTIBLE DEBT INSTRUMENTS AND WARRANTS

Additional requirements for issue of convertible debt instruments

63. (1) In addition to other requirements laid down in these regulations, an issuer making a rights issue of convertible debt instruments shall also comply with the following conditions:

a) it has obtained credit rating from at least one credit rating agency;

b) it has appointed at least one debenture trustee in accordance with the provisions of the Companies Act, 2013 and the Securities and Exchange Board of India (Debenture Trustees) Regulations,1993;

c) it shall create a debenture redemption reserve in accordance with the provisions of the Companies Act, 2013 and rules made there under;

d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:

i. such assets are sufficient to discharge the principal amount at all times;

ii. such assets are free from any encumbrance;

iii. where security is already created on such assets in favour of any existing lender or security trustee or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such lender or security trustee or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;

iv. the security or asset cover shall be arrived at after reduction of the liabilities having a first or prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

(2) The issuer shall redeem the convertible debt instruments in terms of the letter of offer.

Roll over of non-convertible portion of partly convertible debt instruments

64. (1) The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds ten crore rupees, may be rolled over, subject to compliance with the provisions of the Companies Act, 2013 and the following conditions:

a) seventy five per cent. of the holders (in value) of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;

b) the issuer has, along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;

c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to there solution;

d) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of one month prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the rollover;

(2) The creation of fresh security and execution of fresh trust deed shall not be mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments:

Provided that whether the issuer is required to create fresh security and to execute fresh trust deed or not shall be decided by the debenture trustee.

Conversion of optionally convertible debt instruments into equity shares

65. (1) An issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any listed convertible debt instruments issued by an issuer exceeds ten crores and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares:

Provided that where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

Provided that the provisions of sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

Issue of convertible debt instruments for financing

66. An issuer shall not issue convertible debt instruments for financing or for providing loans to or for acquiring shares of any person who is part of the promoter group or group companies:

Provided that an issuer shall be eligible to issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Issue of warrants

67. An issuer shall be eligible to issue warrants subject to the following:

a) the tenure of such warrants shall not exceed eighteen months from their date of allotment in the right issue;

b) a specified security may have one or more warrants attached to it;

c) the price or formula for determination of exercise price of the warrants shall be determined upfront and disclosed in the letter of offer and at least twenty-five per cent. of the consideration amount based on the exercise price shall also be received upfront;

Provided that in case the exercise price of warrants is based on a formula, twenty-five per cent. consideration amount calculated as per the formula with reference date being the record date shall be received upfront.

d) in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within three months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

PART III: RECORD DATE

68. (1) The issuer shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue for such period as may be specified in the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

(2) The issuer shall not withdraw its rights issue after announcement of the record date. However, if the issuer withdraws the rights issue after announcing the record date, it shall not be eligible to make an application for listing of any of its specified securities on any stock exchange for a period of twelve months from the record date announced under sub-regulation (1):

Provided that the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities, ESOPs or exercise of warrants issued prior to the announcement of the record date, on the stock exchange where its securities are listed.

PART IV – APPOINTMENT OF LEAD MANAGERS, OTHER INTERMEDIARIES AND COMPLIANCE OFFICER

69. (1) The issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue.

(2) Where the issue is managed by more than one lead manager, the rights, obligations and responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each lead manager shall be predetermined and be disclosed in the draft letter offer and the letter of offer as specified in **Schedule I**:

(3) At least one lead manager to the issue shall not be an associate (as defined under the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992) of the issuer and if any of the lead manager is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to marketing of the issue.

(4) The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with the Board after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.

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

Provided that such agreements may include such other clauses as the issuer and the intermediaries may deem fit without diminishing or limiting in any way the liabilities and obligations of the lead manager(s), other intermediaries and the issuer under the Act, the Companies Act, 2013 or the Companies Act, 1956 (to the extent applicable), the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made there under or any statutory modification or statutory enactment thereof:

Provided further that in case of ASBA process, the issuer shall take cognisance of the deemed agreement of the issuer with the self-certified syndicate banks.

(6) The issuer shall appoint bankers to an issue, at centres as specified in **Schedule XII**.

(7) The issuer shall appoint a registrar to the issue registered with the Board, which has connectivity with all the depositories:

Provided that if the issuer itself is a registrar, it shall not appoint itself as a registrar to the issue;

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

(8) The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors 'grievances.

PART V: DISCLOSURES IN AND FILING OF LETTERS OF OFFER

Disclosures in the draft letter of offer and letter of offer

70. (1) The draft letter of offer and letter of offer shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision.

(2) Without prejudice to the generality of sub-regulation (1), the draft letter of offer and letter of offer shall contain disclosures as specified in **Part A or Part B** of **Schedule VI, as applicable**.

(3) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft letter of offer and the letter of offer.

(4) The lead manager(s) shall call upon the issuer, its promoters and its directors to fulfill their obligations as disclosed by them in the draft letter of offer and letter of offer and as required in terms of these Regulations.

(5) The lead manager(s) shall ensure that the information contained in the draft letter of offer and letter of offer and the particulars as per audited financial statements in the letter of offer are not more than six months old from the issue opening date.

(6) An issuer shall make disclosures in the draft letter of offer, letter of offer and abridged letter of offer, if the issuer or any of its promoters or directors is a willful defaulter.

Filing of the draft letter of offer and letter of offer

71. (1) Prior to making a rights issue, the issuer shall, except in case of a fast track issue, file a draft letter of offer, with the concerned regional office of the Board under the jurisdiction of which the registered office of the issuer company is located, in accordance with **Schedule IV**, along with fees as specified in **Schedule III**, with the Board and with the stock exchange(s), through the lead manager(s).

Provided that the issuer shall, in case of fast track issue, shall file a letter of offer and pay fees as specified in Schedule III with the Board.

(2) The lead manager(s) shall submit the following to the Board along with the draft letter of offer:

a)a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s) and includes content specified in **Schedule II**;

b)a due diligence certificate as per **Form A** of **Schedule V**;

c)in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per **Form B** of **Schedule V**;

d) A certificate confirming compliance of the conditions specified in **Part E** of **Schedule VI**, if applicable.

(3) The issuer shall also file the draft letter of offer with the stock exchange(s) and shall submit to such stock exchange(s), the Permanent Account Number, bank account number and passport number of its promoters where they are individuals, and Permanent Account Number, bank account number, company registration number or equivalent and the address of the Registrar of Companies with which the promoter is registered, where the promoter is a body corporate.

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

a) the date of receipt of the draft letter of offer, as applicable, under sub-regulation (1); or

b) the date of receipt of satisfactory reply from the lead manager(s), where the Board has sought any clarification or additional information from them; or

c) the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency ; or

d) the date of receipt of a copy of in-principle approval letter issued by the stock exchanges.

(5) If the Board specifies any changes or issues observations on the draft letter of offer the issuer and lead manager(s) shall carry out such changes in the draft letter of offer and shall submit to the Board an updated draft letter of offer complying with the observations issued by the Board and highlighting all changes made in the draft letter of offer before filing the letter of offer with the stock exchanges.

(6) If there are any changes in the draft letter of offer in relation to the matters specified in **Schedule XVI**, an updated letter of offer or a fresh draft letter of offer, as the case may be, shall be filed with the Board along with fees specified in **Schedule III**.

(7) The lead manager(s) shall submit the following documents to the Board after issuance of observations by the Board or after expiry of the period stipulated in sub-regulation (4) of regulation 71 if the Board has not issued observations:

a) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the letter of offer;

b) a due diligence certificate as per **Form C** of **Schedule V**, at the time of submission of the letter of offer with stock exchange(s);

c) a due diligence certificate as per **Form D** of **Schedule V**, in the event the issuer has made a disclosure of any material development by issuing a public notice.

(8) Copy of the letter of offer shall also be filed with the Board and the stock exchanges through the lead manager simultaneously with filing of the letter of offer with the designated stock exchange.

(9) The draft letter of offer and letter of offer shall also be furnished to the Board in a softcopy.

Draft letter of offer and letter of offer to be available to the public

72. (1) The draft letter of offer filed with the Board shall be made public for comments, if any, for a period of at least twenty one days from the date of filing, by hosting it on the websites of the Board, stock exchanges where specified securities are proposed to be listed and the lead manager(s) associated with the issue.

(2) The issuer shall, within two days of filing of the draft letter of offer with the Board, make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing to the public the fact of filing of the draft letter of offer with the Board and inviting the public to provide their comments to the Board, the issuer or to the lead manager(s) in respect of the disclosures made in the draft letter of offer.

(3) The lead manager(s) shall, after expiry of the period stipulated in sub-regulation (1), file with the Board, details of the comments received by them or the issuer from the public, on the draft offer document, during that period and the consequential changes, if any, that are required to be made in the draft offer document.

(4) The issuer and the lead manager(s) shall ensure that the letters of offer are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Board and the stock exchanges, as applicable.

(5) The lead manager(s) and the stock exchanges shall provide copies of the draft letter of offer to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

PART VI: PRICING

73. (1) The issuer shall decide the issue price, in consultation with the lead manager(s), before determining the record date, which shall be determined in consultation with the designated stock exchange.

(2) The issue price shall not be less than the face value of the specified securities.

(3) The issuer shall disclose the issue price in the letter of offer filed with the Board and the stock exchange(s).

PART VII: ISSUANCE CONDITIONS AND PROCEDURE

Reservations

74. (1) The issuer shall make a rights issue of equity shares only if it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof.

(2) The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments shall be issued to the holder of such convertible debt instruments or warrants at the time of conversion of such convertible debt instruments, on the same terms at which the equity shares offered in the rights issue were issued.

(3) Subject to other applicable provision of these regulations, the issuer may make reservation for its employees along with rights issue subject to the condition that the value of allotment to any employee shall not exceed two lakhs rupees.

Provided that in the event of under-subscription in the employee reservation portion, the unsubscribed portion may be allotted on a proportionate basis, for a value in excess of two lakhs rupees, subject to the total allotment to an employee not exceeding five lakhs rupees.

Abridged letter of offer

75. (1) The abridged letter of offer shall contain the disclosures as specified by the Board in **Part F** of **Schedule VI** and shall not contain any matter extraneous to the contents of the letter of offer.

(2) Every application form distributed by the issuer or any other person in relation to the issue shall be accompanied by a copy of the abridged letter of offer.

ASBA

76. The issuer shall provide the ASBA facility in the manner specified by the Board where not more than one payment option is provided.

Provided that the applicants in a rights issue shall be eligible to make applications through ASBA facility only if such applicant: (i) is holding equity shares in dematerialised mode; (ii) has not renounced entitlement in part or in full; and (iii) is not a renouncee.

Provided further that payment made for application for any reserved portion outside the issue period can be through electronic banking modes.

Availability of letter of offer and other issue materials

77. (1) The lead manager(s) shall ensure availability of the letter of offer and other issue material including application forms with stock exchanges, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, investors' associations and self-certified syndicate banks before the opening of the issue.

(2) The abridged letter of offer, along with application form, shall be despatched through registered post or speed post or by courier service or by electronic transmission to all the existing shareholders at least three days before the date of opening of the issue.

(3) The letter of offer shall also be provided by the issuer or lead manager(s) to any existing shareholder who makes a request in this regard.

Conditions for making applications on plain paper

78. (1) Shareholders who have not received the application form may make an application in writing on a plain paper, along with the requisite application money.

(2) Shareholders making an application on plain paper shall not be entitled to renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently.

(3) If a shareholder makes an application both in an application form as well as on a plain paper, both applications are liable to be rejected.

Prohibition on payment of incentives

79. Any person connected with the issue, shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the rights issue, except for fees or commission for services rendered in relation to the issue.

Security deposit

80. (1) The issuer shall, before the opening of the subscription list, deposit with the designated stock exchange, an amount calculated at the rate of one per cent. of the issue size in the manner specified by the Board and/or stock exchange(s).

(2) The amount specified in sub-regulation (1) shall be refundable or forfeitable in the manner specified by the Board.

Underwriting

81. (1) If the issuer desires to have the issue underwritten, it shall appoint underwriters in accordance with the Securities and Exchange Board of India (Underwriters) Regulations, 1993.

Provided that the issue can be underwritten only to the extent of entitlement of shareholders other than the promoters and promoter group.

(2) In case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

Monitoring agency

82. (1) If the issue size exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by a scheduled commercial bank named in the letter of offer as a banker of the issuer:

Provided that nothing contained in this clause shall apply to an issue of specified securities made by a bank or public financial institution or an insurance company.

(2) The monitoring agency shall submit its report to the issuer in the format specified in **Schedule XI** on a quarterly basis, till at least ninety five per cent. of the proceeds of the issue, excluding the proceeds raised for general corporate purposes, have been utilised.

(3) The board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency as specified in **Schedule XI**.

(4) The issuer shall, within forty five days from the end of each quarter, publicly disseminate the report of the monitoring agency by uploading the same on its website as well as submitting the same to the stock exchange(s) on which its equity shares are listed.

Public communications, publicity materials, advertisements and research reports.

83. All public communication, publicity materials, advertisements and research reports shall comply with the provisions of **Schedule IX**.

Issue-related advertisements

84. (1) The issuer shall issue an advertisement in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation, at the place where registered office of the issuer is situated, at least three days before the date of opening of the issue, disclosing the following:

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

b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application form in case they do not receive the application form within a reasonable time after opening of the rights issue;

c) a statement that if the shareholders entitled to receive the rights entitlements have neither received the original application forms nor they are in a position to obtain the duplicate form, they may make application in writing on a plain paper to subscribe to the rights issue along with a format specifying therein necessary particulars such as name, address, ratio of rights issue, issue price, number of equity shares held, ledger folio numbers, depository participant ID, client ID, number of equity shares entitled and applied for, additional shares if any, amount to be paid along with application, and particulars of cheque, etc. to be drawn in favour of the issuer‘s account;

d) a statement that the applications can be directly sent by the shareholders through registered post together with the application monies to the issuer's designated official at the address given in the advertisement;

e) a statement to the effect that if the shareholder makes an application using the application form as well as plain paper, both the applications shall be liable to be rejected at the option of the issuer.

(2) During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed, or indicating investors' response to the issue.

(3) An announcement regarding closure of issue shall be made only after the lead manager(s) is satisfied that at least ninety per cent. of the offer through letter of offer has been subscribed and a certificate has been obtained to that effect from the registrar to the issue:

Provided that such an announcement shall not be made before the date on which the issue is to be closed except for issue closing advertisement made in the format prescribed in these regulations.

Opening of the issue

85. Subject to the compliance with the provisions of the Companies Act, 2013, a rights issue may be opened within twelve months from the date of issuance of the observations by the Board under regulation71.

Provided that in case of a fast track issue, the issue shall open within twelve months from the record date.

Minimum subscription

86. (1) The minimum subscription to be received in the issue shall be at least ninety per cent. of the offer through the offer document.

(2) In the event of non-receipt of minimum subscription referred to in sub-regulation (1), all application monies received shall be refunded to the applicants forthwith, but not later than fifteen days from the closure of the issue.

Period of subscription

87. The rights issue shall be kept open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

Payment options

88. The issuer shall give one of the following payment options to all the shareholders for each type of instrument:

a) part payment on application with balance money to be paid in calls; or

b) full payment on application:

Provided that the part payment, if any, on application shall not be less than twenty five per cent. of the issue price and such issuer shall obtain the necessary regulatory approvals to facilitate the same.

Manner of calls

89. If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited:

Provided further that it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 82.

Allotment procedure and basis of allotment

90. (1) The issuer shall not make any allotment in excess of the specified securities offered through the letter of offer.

(2) Allotment shall be made in the following manner:

a) Full allotment to those eligible shareholders who have applied for their rights entitlement either in full or in part and also to the renouncee(s), who has/have applied for the specified securities renounced in their favour, in full or in part, as adjusted for fractional entitlement

b) Allotment to eligible shareholders who having applied for the specified securities in full to the extent of their rights entitlement and have also applied for additional specified securities, shall be made as far as possible on an equitable basis having due regard to the number of specified securities held by them on the record date, provided there is an under- subscribed portion after making allotment in (a)above.

c) Allotment to the renouncees, who having applied for the specified securities renounced in their favour and also applied for additional specified securities, provided there is an under-subscribed portion after making full allotment specified in (a) and (b) above. The allotment of such additional specified securities may be made on a proportionate basis.

(3) The authorised employees of the designated stock exchange along with the lead manager(s) and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner as may be prescribed by the Board.

Allotment, refund and payment of interest

91. (1) The issuer and lead manager(s) shall ensure that the specified securities are allotted and/or application monies are refunded or unblocked within such period as may be specified by the Board.

(2) The lead manager(s) shall ensure that the allotment, credit of dematerialised securities, refunding or unblocking of application monies, as may be applicable, are done electronically.

(3) Where the specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated in sub-regulation (1) above, the issuer shall undertake to pay interest at the rate of fifteen per cent. per annum to the shareholders within such time as disclosed in the draft letter of offer and the letter of offer and the lead manager(s) shall ensure the same.

Post-issue advertisements

92. (1) The lead manager(s) shall ensure that an advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of dispatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the Registrar, date of despatch of certificates or date of credit of specified securities, as applicable, and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

(2) Details specified in sub regulation (1) shall also be placed on the websites of the stock exchanges where the securities are listed.

Post-issue responsibilities of the lead manager(s)

93. (1) The responsibility of the lead manager(s) shall continue until completion of the issue process and for any issue related matter thereafter.

(2) The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.

(3) The lead manager(s) shall continue to be responsible for post-issue activities till the applicants have received the securities certificates, credit to their demat account or refund of application monies and the listing agreement is entered into by the issuer with the stock exchange and listing or trading permission is obtained.

(4) The lead manager(s) shall be responsible for and co-ordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from collecting bank branches and/ or self-certified syndicate banks, processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, despatch of security certificates or credit of the specified securities to the dematerialised accounts of the allottees, as applicable and unblocking of ASBA accounts/ despatch of refund orders are completed and securities are listed, as applicable.

(5) Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to the Board.

(6) In case there is a devolvement on underwriters, the lead manager(s) shall ensure that the notice for devolvement containing the obligation of the underwriters is issued within ten days from the date of closure of the issue.

(7) In case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information to the Board in respect of underwriters who have failed to meet their underwriting devolvement in the format specified in **Schedule XVIII**.

Release of subscription money

94. (1) The lead manager(s) shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue.

(2) In case the issuer fails to obtain listing or trading permission from the stock exchanges where the specified securities were listed, it shall refund through verifiable means the entire monies received within seven days of receipt of intimation from stock exchanges rejecting the application for listing of specified securities, and if any such money is not repaid within eight days after the issuer becomes liable to repay it the issuer and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent. Per annum.

(3) The lead manager(s) shall ensure that the monies received in respect of the rights issue are released to the issuer in compliance with the provisions of sub-section (3) of section 40 of the Companies Act, 2013, as applicable.

Reporting of transactions of the promoters and promoter group

95. The issuer shall ensure that all transactions in securities by the promoters and promoter group between the date of filing of the draft letter of offer or letter of offer, as the case may be, and the date of closure of the issue shall be reported to the stock exchanges where the specified securities of the issuer are to be listed, within twenty four hours of such transactions.

Post-issue reports

96. The lead manager(s) shall submit post-issue reports as follows:

a) initial post-issue report as specified in **Part B** of **Schedule XVII**, within three working days of closure of the issue;

b) final post-issue report as specified in **Part C** of **Schedule XVII**, within fifteen days of the date of finalization of basis of allotment or within fifteen days of refund of money in case of failure of the issue.

PART VIII: MISCELLEANEOUS

Restriction on further capital issues

97. An issuer shall not make any further issue of specified securities in any manner whether by way of public issue, rights issue, preferential issue, qualified institutions placement, issue of bonus shares or otherwise, except pursuant to an employee stock options scheme:

a) in case of a fast track issue, during the period between the date of filing the letter of offer with the stock exchanges where the securities are proposed to be listed and the listing of the specified securities offered through the letter of offer or refund of application monies; or

b) in case of other issues, during the period between the date of filing the draft letter of offer with the Board and the listing of the specified securities offered through the letter of offer or refund of application monies; unless full disclosures regarding the total number of specified securities or amount proposed to be raised from such further issue are made in such draft letter of offer or letter of offer, as the case may be.

Alteration of rights of holders of specified securities

98. The issuer shall not alter the terms (including the terms of issue) of specified securities which may adversely affect the interests of the holders of those specified securities, except with the consent in writing of the holders of not less than three-fourths of the specified securities of that class or with the sanction of a special resolution passed at a meeting of the holders of the specified securities of that class.

PART IX: FAST TRACK RIGHTS ISSUE

Eligibility conditions

99. Unless otherwise specified, nothing contained in sub-regulations (1), (2), (4) and (5) of regulation 71 shall apply if the issuer satisfies the following conditions for making a rights issue through the fast track route -

a) the equity shares of the issuer have been listed on any stock exchange for a period of at least three years immediately preceding the reference date;

b) the entire shareholding of the promoter group of the issuer is held in dematerialised form on the reference date;

c) the average market capitalisation of public shareholding of the issuer is at least two hundred and fifty crore rupees;

d) the annualised trading turnover of the equity shares of the issuer during six calendar months immediately preceding the month of the reference date has been at least two per cent. of the weighted average number of equity shares listed during such six months‘ period:

Provided that for issuers, whose public shareholding is less than fifteen per cent of its issued equity capital, the annualised trading turnover of its equity shares has been at least two per cent. of the weighted average number of equity shares available as free float during such six months‘ period;

e) the annualized delivery-based trading turnover of the equity shares during six calendar months immediately preceding the month of the reference date has been at least ten per cent. of the annualized trading turnover of equity shares during such six months‘ period;

f)the issuer has been in compliance with the equity listing agreement or the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, as applicable, for a period of at least three years immediately preceding the reference date:

Provided that if the issuer has not complied with the provisions of the listing agreement or the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, as applicable, relating to composition of board of directors, for any quarter during the last three years immediately preceding the reference date, but is compliant with such provisions at the time of filing of letter of offer, and adequate disclosures are made in the letter of offer about such non-compliances during the three years immediately preceding the reference date, it shall be deemed as compliance with the condition;

Provided further that imposition of only monetary fines by stock exchanges on the issuer shall not be a ground for ineligibility for undertaking issuances under this regulation;

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

h) that no show-cause notices have been issued or prosecution proceedings have been initiated by the Board and pending against the issuer or its promoters or whole-time directors as on the reference date;

i) the issuer or promoter or promoter group or director of the issuer has not settled any alleged violation of securities laws through the consent or settlement mechanism with the Board during three years immediately preceding the reference date;

j) the equity shares of the issuer have not been suspended from trading as a disciplinary measure during last three years immediately preceding the reference date;

k) there shall be no conflict of interest between the lead manager(s) and the issuer or its group companies in accordance with the applicable regulations.

l) the promoters and promoter group shall mandatorily subscribe to their rights entitlement and shall not renounce their rights, except to the extent of renunciation within the promoter group or for the purpose of complying with minimum public shareholding norms prescribed under the Securities Contracts (Regulation) Rules,1957;

m) there are no audit qualifications on the audited accounts of the issuer in respect of those financial years for which such accounts are disclosed in the letter of offer.

Explanation: For the purpose of this regulation:

i. "average market capitalisation of public shareholding" means the sum of daily market capitalisation of public shareholding for a period of one year up to the end of the quarter preceding the month in which the proposed issue was approved by the shareholders or the board of the issuer, as the case may be, divided by the number of trading days.

ii. "public shareholding" shall have the same meaning as assigned to it under the Securities Contracts (Regulation) Rules,1957.

iii. "reference date" means the date of filing the letter of offer with the designated stock exchange.

iv. "audit qualifications" for this regulation shall be those disclosed under applicable accounting standard relating to modification to the opinion in the independent auditor's report and requires a qualified opinion, adverse opinion or disclaimer of opinion for material misstatements.

Issue conditions

100. (1) The issuer shall file the letter of offer in accordance with sub-regulation 8 and 9 of regulation 71 and shall pay fees to the Board as specified in **Schedule III**.

(2) The lead manager(s) shall submit to the Board, the following documents along with the letter of offer:

a) a due diligence certificate as per **Form A** of **Schedule V** including additional confirmations as specified in **Form E** of **Schedule V**;

b) in case of a fast track issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per **Form B** of **Schedule V**.

CHAPTER IV

FURTHER PUBLIC OFFER

PART I: ELIGIBILITY REQUIREMENTS

Reference date

101. Unless otherwise provided in this Chapter, an issuer making a further public offer of specified securities shall satisfy the conditions of this Chapter as on the date of filing of the draft offer document with the Board and also as on the date of registering the offer document with the Registrar of Companies.

Entities not eligible to make a further public offer

102. An issuer shall not be eligible to make a further public offer:

a) if the issuer, any of its promoters, promoter group or directors, selling shareholders are debarred from accessing the capital market by the Board;

b) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board;

c) if the issuer or any of its promoters or directors is a willful defaulter;

d) if any of its promoters or directors is a fugitive economic offender.

Explanation: The restrictions under (a) and (b) above shall not apply to the persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft offer document with the Board.

Eligibility requirements for further public offer

103. (1) An issuer may make a further public offer, if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by its new name.

(2) An issuer not satisfying the condition stipulated in sub-regulation (1) may make a further public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent. of the net offer, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

General conditions

104. (1) An issuer making a further public offer shall ensure that-

a) it has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of **Schedule XIX**;

b) it has entered into an agreement with a depository for dematerialisation of specified securities already issued and proposed to be issued;

c) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

d) it has made firm arrangements of finance through verifiable means towards seventy five per cent. of the stated means of finance for the specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

(2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed twenty five per cent. of the amount being raised by the issuer.

Explanation: For the purposes of this regulation, “project” means the object for which monies are proposed to be raised to cover the objects of the issue.

Additional conditions for an offer for sale

105. Only such fully paid-up equity shares may be offered for sale to public which have been held by the selling shareholder(s) for a period of at least one year prior to the filing of the draft offer document:

Provided further that such holding period of one year shall be required to be complied with at the time of filing of the draft offer document.

Provided that in case the equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities, including depository receipts, as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period referred in this sub-regulation.

Explanation: If the equity shares arising out of the conversion or exchange of the fully paid-up compulsorily convertible securities are being offered for sale, the conversion or exchange should be completed prior to filing of the offer document (i.e. red herring prospectus in the case of a book built issue and prospectus in the case of a fixed price issue), provided full disclosures of the terms of conversion or exchange are made in the draft offer document.

Provided further that the requirement of holding the equity shares for a period of one year shall not apply:

a) in case of an offer for sale of a government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in the infrastructure sector;

b) if the equity shares offered for sale were acquired pursuant to any scheme approved by a High Court under the sections 391 to 394 of the Companies Act, 1956, or approved by a tribunal or the Central Government under the sections 230 to 234 of the Companies Act, 2013, as applicable, in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme;

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

(i) such specified securities being issued out of free reserves and share premium existing in the books of account as at the end of the financial year preceding the financial year in which the draft offer document is filed with the Board; and

(ii) such equity shares not being issued by utilisation of revaluation reserves or unrealized profits of the issuer.

PART II: ISSUE OF CONVERTIBLE DEBT INSTRUMENTS AND WARRANTS

106. An issuer shall be eligible to make a further public offer of convertible debt instruments if its equity shares are already listed;

Provided that it is not in default in payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months.

Additional requirements for issue of convertible debt instruments

107. (1) In addition to other requirements laid down in these regulations, an issuer making a public issue of convertible debt instruments shall also comply with the following conditions:

a) it has obtained credit rating for such convertible debt instrument from one or more credit rating agencies;

b) it has appointed at least one debenture trustee in accordance with the provisions of the Companies Act, 2013 and the Securities and Exchange Board of India (Debenture Trustees) Regulations,1993;

c) it shall create a debenture redemption reserve in accordance with the provisions of the Companies Act, 2013 and rules made there under;

d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:

i.such assets are sufficient to discharge the principal amount at all times;

ii. such assets are free from any encumbrance;

iii. where security is already created on such assets in favour of public financial institutions or scheduled commercial banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such public financial institution, scheduled commercial bank or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;

iv the security or asset cover shall be arrived at after reduction of the liabilities having a first or prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

(2) The issuer shall redeem the convertible debt instruments in terms of the offer document.

Roll over of non-convertible portion of partly convertible debt instruments

108. The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds ten crore rupees, may be rolled over, subject to compliance with the provisions of the Companies Act, 2013 and the following conditions:

a) seventy five per cent. of the holders (in value) of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;

b) the issuer has, along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;

c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution;

d) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of one month prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the rollover.

(2) The creation of fresh security and execution of fresh trust deed shall not be mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments:

Provided that the debenture trustee shall decide if the issuer is required to create fresh security and to execute fresh trust deed.

Conversion of optionally convertible debt instruments into equity share capital

109. (1) The issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any listed convertible debt instruments issued by an issuer exceeds ten crore rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares:

Provided that where the upper limit or conversion formula on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

(4) The provisions of sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

Issue of convertible debt instruments for financing

110. An issuer shall not issue convertible debt instruments for financing or for providing loans to or for acquiring shares of any person who is part of the promoter group or group companies:

Provided that an issuer shall be eligible to issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Issue of warrants

111. An issuer shall be eligible to issue warrants in a further public offer subject to the following conditions:

a) the tenure of such warrants shall not exceed eighteen months from the date of their allotment in the public issue;

b) a specified security may have one or more warrants attached to it;

c) the price or formula for determination of exercise price of the warrants shall be determined upfront and at least twenty-five per cent. of the consideration amount based on the exercise price shall also be received upfront;

Provided that in case the exercise price of warrants is based on a formula, twenty-five per cent. consideration amount based on the cap price of the price band determined for the linked equity shares or convertible securities shall be received upfront.

d) in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within three months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

PART III: PROMOTERS' CONTRIBUTION

Requirement of minimum promoters' contribution not applicable in certain cases

112. The requirements of minimum promoters' contribution shall not apply in case of:

a) an issuer which does not have any identifiable promoter;

b) where the equity shares of the issuer are frequently traded on a stock exchange for a period of at least three years and the issuer has a track record of dividend payment for at least three immediately preceding years:

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

Explanation: The reference date for the purpose of computing the annualised trading turnover referred to in the said Explanation shall be the date of filing the draft offer document with the Board and in case of a fast track issue, the date of filing the offer document with the Registrar of Companies, and before opening of the issue.

Minimum promoters' contribution

113. (1) The promoters shall contribute in the public issue as follows:

a) either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post-issue capital;

b) in case of a composite issue (i.e. further public offer cum rights issue), either to the extent of twenty per cent. of the proposed issue size or to the extent of twenty per cent. of the post- issue capital excluding the rights issue component.

(2) In case of a public issue or composite issue of convertible securities, the minimum promoters' contribution shall be as follows:

a) the promoters shall contribute twenty per cent. as stipulated in clause (a) or (b) of sub-regulation (1), as the case may be, either by way of equity shares or by way of subscription to the convertible securities:

Provided that if the price of the equity shares allotted pursuant to conversion is not pre-determined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public issue and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities.

b) in case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre-determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities.

(3) In case of a further public offer or composite issue where the promoters contribute more than the stipulated minimum promoters' contribution, the allotment with respect to excess contribution shall be made at a price determined in terms of the provisions of regulation 164 or the issue price, whichever is higher.

(4) In case the promoters have to subscribe to equity shares or convertible securities towards promoters' contribution, the promoters shall satisfy the requirements of this regulation at least one day prior to the date of opening of the issue and the amount of promoters' contribution shall be kept in an escrow account with a scheduled commercial bank and shall be released to the issuer along with the release of the issue proceeds:

Provided further that where the minimum promoters' contribution is more than one hundred crore rupees and the further public offer is for partly paid shares, the promoters shall bring in at least one hundred crore rupees before the date of opening of the issue and the remaining amount may be brought on a pro-rata basis before the calls are made to the public.

Explanation:

(I) For the purpose of this regulation, promoters' contribution shall be computed on the basis of the post-issue expanded capital:

a) assuming full proposed conversion of convertible securities into equity shares;

b) assuming exercise of all vested options, where any employee stock options are outstanding at the time of further public offer.

(II) For computation of "weighted average price":

a) "weight" means the number of equity shares arising out of conversion of such specified securities into equity shares at various stages;

b) "price" means the price of equity shares on conversion arrived at after taking into account predetermined conversion price at various stages.

Securities ineligible for minimum promoters' contribution

114. (1) For the computation of minimum promoters' contribution, the following specified securities shall not be eligible:

a) specified securities acquired during the preceding three years, if these are:

i. acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or

ii. resulting from a bonus issue by utilisation of revaluation reserves or unrealised profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters 'contribution;

b) specified securities pledged with any creditor other than those for borrowings by the issuer or its subsidiaries.

(2) Specified securities referred to in clauses (a) of sub-regulation (1) shall be eligible for the computation of promoters' contribution, if such securities are acquired pursuant to a scheme which has been approved by the High Court under section 391 to 394 of the Companies Act, 1956 or approved by a tribunal or the Central Government under section 230 to 234 of the Companies Act,2013.

PART IV: LOCK-IN AND RESTRICTIONS ON TRANSFERABILITY

Lock-in of specified securities held by the promoters

115. The specified securities held by the promoters shall not be transferable (hereinafter referred to as "locked-in") for the periods as stipulated hereunder:

a) minimum promoters' contribution including contribution made by alternative investment funds, or foreign venture capital investors, as applicable, shall be locked-in for a period of three years from the date of commencement of commercial production or from the date of allotment in the further public offer, whichever is later;

b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year:

Provided that the excess promoters' contribution as provided in the proviso to clause (b) of regulation 112 shall not be subject to lock-in.

Explanation: For the purposes of this regulation, the expression "date of commencement of commercial production" means the last date of the month in which commercial production of the project in respect of which the funds raised are proposed to be utilised as stated in the offer document, is expected to commence.

Lock-in of specified securities lent to stabilising agent under green shoe option

116. The lock-in provisions of this part shall not apply with respect to the specified securities lent to stabilising agent for the purpose of green shoe option, during the period starting from the date of lending of such specified securities and ending on the date on which they are returned to the lender in terms of sub-regulation (5) or (6) of regulation153:

Provided that the specified securities shall be locked-in for the remaining period from the date on which they are returned to the lender.

Lock-in of party-paid securities

117. Where the specified securities which are subject to lock-in are partly paid-up and the amount called-up on such specified securities is less than the amount called-up on the specified securities issued to the public, the lock-in shall end only on the expiry of three years after such specified securities have become pari passu with the specified securities issued to the public.

Inscription or recording of non-transferability

118. The certificates of specified securities which are subject to lock-in shall contain the inscription “non- transferable” and specify the lock-in period and in case such specified securities are dematerialized, the issuer shall ensure that the lock-in is recorded by the depository.

Pledge of locked-in specified securities

119. Specified securities held by the promoters and locked in may be pledged as collateral security for a loan granted by a scheduled commercial bank or a public financial institution or a systemically important non-banking finance company or a housing finance company, subject to the following:

a) if the specified securities are locked-in in terms of clause (a) of regulation 115, the loan has been granted to the issuer company or its subsidiary/subsidiaries for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan

b) if the specified securities are locked-in in terms of clause (b) of regulation 115 and the pledge of specified securities is one of the terms of sanction of the loan.

Transferability of locked-in specified securities

120. Subject to the provisions of the Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 2011, the specified securities held by the promoters and locked-in as per regulation 115 may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer:

Provided that lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

PART V: APPOINTMENT OF LEAD MANAGERS, OTHER INTERMEDIARIES AND COMPLIANCE OFFICER

121. (1) The issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue.

(2) Where the issue is managed by more than one lead manager, the rights, obligations and responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each lead manager shall be predetermined and be disclosed in the draft offer document and the offer document as specified in **Schedule I**:

(3) At least one lead manager to the issue shall not be an associate [as defined under the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992] of the issuer and if any of the lead managers is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to the marketing of the issue.

(4) The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with the Board after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.

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

Provided that such agreements may include such other clauses as the issuer and the intermediaries may deem fit without diminishing or limiting in any way the liabilities and obligations of the lead manager(s), other intermediaries and the issuer under the Act, the Companies Act, 2013 or the Companies Act, 1956 (to the extent applicable), the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made there under or any statutory modification or statutory enactment thereof:

Provided further that in case of ASBA process, the issuer shall take cognisance of the deemed agreement of the issuer with the self-certified syndicate banks.

(6) The issuer shall, in the case of an issue made through the book building process, appoint syndicate member(s) and in the case of any other issue, appoint bankers to an issue, at centres as specified in **Schedule XII**.

(7) The issuer shall appoint a registrar to the issue, registered with the Board, which has connectivity with all the depositories:

Provided that if issuer itself is a registrar, it shall not appoint itself as a registrar to the issue:

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

(8) The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

PART VI: DISCLOSURES IN AND FILING OF OFFER DOCUMENTS

Disclosures in the draft offer document and the offer document

122. (1) The draft offer document and the offer document shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision.

(2) Without prejudice to the generality of sub-regulation (1), the red-herring prospectus, shelf prospectus and prospectus shall contain:

i. disclosures specified in the Companies Act, 2013; and

ii. disclosures specified in **Part A** of **Schedule VI**, subject to the provisions of **Parts C and D** thereof.

(3) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosures made in the draft offer document and the offer document.

(4) The lead manager(s) shall call upon the issuer, its promoters and its directors or in case of an offer for sale, the selling shareholders, to fulfill their obligations as disclosed by them in the draft offer document and the offer document and as required in terms of these Regulations.

(5) The lead manager(s) shall ensure that the information contained in the offer document and the particulars as per audited financial statements in the offer document are not more than six months old from the issue opening date.

Filing of the draft offer document and offer documents

123. (1) Prior to making a further public offer, the issuer shall file three copies of the draft offer document with the concerned regional office of the Board under the jurisdiction of which the registered office of the issuer company is located, in accordance with **Schedule IV**, along with fees as specified in **Schedule III**, through the lead manager(s).

(2) The lead manager(s) shall submit the following to the Board along with the draft offer document:

a) a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s)

b) a due diligence certificate as per **Form A** of **Schedule V;**

c) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per **Form B** of **Schedule V;**

d) a certificate confirming compliance of the conditions specified in **Part C** of **Schedule VI**.

(3) The issuer shall also file the draft offer document with the stock exchange(s) where the specified securities are proposed to be listed, and shall submit to the stock exchange(s),the Permanent Account Number, bank account number and passport number of its promoters where they are individuals, and Permanent Account Number, bank account number, company registration number or equivalent and the address of the Registrar of Companies with which the promoter is registered, where the promoter is a body corporate.

(4) The Board may specify changes or issue observations on the draft offer document within a period of thirty days from the later of the following dates:

a) the date of receipt of the draft offer document under sub-regulation (1);or

b) the date of receipt of satisfactory reply from the lead manager(s), where the Board has sought any clarification or additional information from them or

c) the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or

d) the date of receipt of a copy of in-principle approval letter issued by the stock exchange(s).

(5) If the Board specifies changes or issues observations on the draft offer document, the issuer and the lead manager(s) shall carry out such changes in the draft offer document and shall submit to the Board an updated draft offer document complying with the observations issued by the Board and highlighting all changes made in the draft offer document before registering or filing the offer documents with the Registrar of Companies or the appropriate authority, as applicable.

(6) If there are any changes in the draft offer document in relation to the matters specified in **Schedule XVI**, the updated offer document or a fresh draft offer document, as the case may be, shall be filed with the Board along with fees specified in **Schedule III**.

(7) Copy of the offer documents shall also be filed with the Board and the stock exchanges through the lead manager(s) simultaneously while registering the offer documents with Registrar of Companies.

(8) The draft offer document and the offer document shall also be furnished to the Board in a soft copy in the manner as may be specified.

(9) The lead manager(s) shall submit the following documents to the Board after issuance of observations by the Board or after expiry of the period stipulated in sub-regulation (4) of regulation 123 if the Board has not issued observations:

a) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the offer document;

b) a due diligence certificate as per **Form C** of **Schedule V**, at the time of registering of the offer document;

c) a copy of the resolution passed by the board of directors of the issuer for allotting specified securities to promoters towards amount received against promoters' contribution, before opening of the issue;

d) a certificate from a Chartered Accountant, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid and credited to the bank account of the issuer by each of them towards such contribution;

e) a due diligence certificate as per **Form D** of **Schedule V**, in the event the issuer has made a disclosure of any material development by issuing a public notice.

Draft offer document and offer document to be available to the public

124. (1) The draft offer document filed with the Board shall be made public for comments, if any, for a period of at least twenty one days from the date of filing, by hosting it on the websites of the Board, stock exchanges where specified securities are proposed to be listed and lead manager(s) associated with the issue.

(2) The issuer shall, within two days of filing the draft offer document with the Board, make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing to the public the fact of filing of the draft offer document with the Board and inviting the public to provide their comments to the Board, the issuer or the lead manager(s) in respect of the disclosures made in the draft offer document.

(3) The lead manager(s) shall, after expiry of the period stipulated in sub-regulation (1), file with the Board, details of the comments received by them or the issuer from the public, on the draft offer document, during that period and the consequential changes, if any, that are required to be made in the draft offer document.

(4) The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, the Board and the stock exchanges, as applicable.

(5) The lead manager(s) and the stock exchanges shall provide copies of the offer documents, to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

PART VII - PRICING

Face value of equity shares

125. The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, advertisements and application forms, along with the price band or the issue price in identical font size.

Pricing

126. (1) The issuer may determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book building process, as the case maybe.

(2) The issuer shall undertake the book building process in the manner specified in **Schedule XIII**.

Price and price band

127. (1) The issuer may mention a price or a price band in the offer document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

(2) The cap on the price band, and the coupon rate in case of convertible debt instruments, shall be less than or equal to one hundred and twenty percent of the floor price.

(3) The floor price or the final price shall not be less than the face value of the specified securities.

(4) Where the issuer opts not to make the disclosure of the floor price or price band in the red herring prospectus, the issuer shall announce the floor price or the price band at least one working day before the opening of the bid in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of **Schedule** X.

(5) The announcement referred to in sub-regulation (4) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section title “basis of issue price” of the offer document.

(6) The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the stock exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the stock exchange(s).

Differential pricing

128. (1) The issuer may offer its specified securities at different prices, subject to the following:

a) retail individual investors or retail individual shareholders or employees entitled for reservation made under regulation 130 may be offered specified securities at a price not lower than by more than ten per cent. of the price at which net offer is made to other categories of applicants, excluding anchor investors;

b) in case of a book built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants;

c) in case of a composite issue, the price of the specified securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference shall be given in the offer document.

d) in case the issuer opts for the alternate method of book building in terms of **Part D** of **Schedule XIII**, the issuer may offer the specified securities to its employees at a price not lower by more than ten per cent. of the floor price.

(2) Discount, if any, shall be expressed in rupee terms in the offer document.

PART VIII: ISSUANCE CONDITIONS AND PROCEDURE

Allocation in the net offer

129. (1) In an issue made through the book building process under sub-regulation (1) of regulation 103, the allocation in the net offer category shall be as follows:

a) Not less than thirty five percent to retail individual investors;

b) Not less than fifteen per cent. to non-institutional investors;

c) Not more than fifty per cent. to qualified institutional buyers, five per cent. of which shall be allocated to mutual funds:

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in any other category:

Provided further that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

(2) In an issue made through the book building process under sub-regulation (2) of regulation 103, the allocation in the net offer category shall be as follows:

a) Not more than ten per cent. to retail individual investors;

b) Not more than fifteen per cent. to non-institutional investors;

c) Not less than seventy five per cent. to qualified institutional buyers, five per cent. of which shall be allocated to mutual funds:

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category:

Provided further that in addition to five per cent allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

(3) In an issue made through the book building process, the issuer may allocate up to sixty per cent. of the portion available for allocation to qualified institutional buyers to anchor investors in accordance with the conditions specified in this regard in **Schedule XIII**.

(4) In an issue made other than through the book building process, allocation in the net offer category shall be made as follows:

a) minimum fifty per cent. to retail individual investors; and

b) remaining to:

(i) individual applicants other than retail individual investors; and

(ii) other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

Explanation: For the purpose of sub-regulation (4), if the retail individual investor category is entitled to more than fifty per cent. of the issue size on a proportionate basis, the retail individual investors shall be allocated that higher percentage.

Reservation on a competitive basis

130. (1) The issuer may make reservations on a competitive basis out of the issue size excluding promoters' contribution in favour of the following categories of persons:

a) employees;

b) shareholders (other than promoters and promoter group) of listed subsidiaries or listed promoter companies:

Provided that the issuer shall not make any reservation for the lead manager(s), registrar, syndicate member(s), their promoters, directors and employees and for the group or associate companies (as defined under the Companies Act, 2013) of the lead manager(s), registrar and syndicate member(s) and their promoters, directors and employees.

(2) In a further public offer, other than in a composite issue, the issuer may make a reservation on a competitive basis out of the issue size excluding promoters' contribution r for the existing retail individual shareholders of the issuer.

(3) The reservations on competitive basis shall be subject to following conditions:

a) The aggregate of reservation for employees shall not exceed five per cent. of the post-issue capital of the issuer and the value of allotment to any employee shall not exceed two lakhs rupees:

Provided that in the event of under-subscription in the employee reservation portion, the unsubscribed portion may be allotted on a proportionate basis, for a value in excess of two lakhs rupees, subject to the total allotment to an employee not exceeding five lakhs rupees.

b) Reservation for shareholders shall not exceed ten percent.of the issue size;

c) no further application for subscription in the net offer can be made by persons (except an employee and retail individual shareholder of the listed issuer and retail individual shareholders of listed subsidiaries of listed promoter companies) in favour of whom reservation on a competitive basis is made;

d) any unsubscribed portion in any reserved category may be added to any other reserved category/categories and the unsubscribed portion, if any, after such inter-se adjustments amongst the reserved categories shall be added to the net offer category;

e) in case of under-subscription in the net offer category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net public offer.

(4) An applicant in any reserved category may make an application for any number of specified securities, but not exceeding the reserved portion for that category.

Abridged prospectus

131. (1) The abridged prospectus shall contain the disclosures as specified in **Part E** of **Schedule VI** and shall not contain any matter extraneous to the contents of the offer document.

(2) Every application form distributed by the issuer or any other person in relation to an issue shall be accompanied by a copy of the abridged prospectus.

ASBA

132. The issuer shall accept bids using only the ASBA facility in the manner specified by the Board.

Availability of issue material

133. The lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, investors' associations and self certified syndicate banks before the opening of the issue.

Prohibition on payment of incentives

134. Any person connected with the issue, shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the initial public offer, except for fees or commission for services rendered in relation to the issue.

Security deposit

135. (1) The issuer shall, before the opening of the subscription list, deposit with the designated stock exchange, an amount calculated at the rate of one per cent. of the issue size available for subscription to the public in the manner specified by the Board and/or the stock exchange(s).

(2) The amount specified in sub-regulation (1) shall be refundable or forfeitable in the manner specified by the Board.

Underwriting

136. (1) If the issuer making a further public offer, other than through the book building process, desires to have the issue underwritten, it shall appoint the underwriters in accordance with the Securities and Exchange Board of India (Underwriters) Regulations,1993.

(2) If the issuer makes a public issue through the book building process,

a) the issue shall be underwritten by lead manager(s) and syndicate member(s):

Provided that at least seventy five per cent.of the net offer proposed to be compulsorily allotted to qualified institutional buyers for the purpose of compliance of the eligibility conditions specified in sub-regulation (2) of regulation 103, shall not be underwritten.

b) the issuer shall, prior to filing the prospectus, enter into underwriting agreement with the lead manager(s), and syndicate member(s), indicating there in the number of specified securities which they shall subscribe to at the predetermined price in the event of under- subscription in the issue.

c) if the syndicate member(s) fail to fulfil their underwriting obligations, the lead manager(s) shall fulfill the underwriting obligations.

d) the lead manager(s) and syndicate member(s) shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.

e) in case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations,1992.

f) where the issue is required to be underwritten, the underwriting obligations should at least be to the extent of minimum subscription.

Monitoring agency

137. (1) If the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by a scheduled commercial bank named in the offer document as the bankers of the issuer:

Provided that nothing contained in this clause shall apply to an issue of specified securities made by a bank or public financial institution or an insurance company.

(2) The monitoring agency shall submit its report to the issuer in the format specified in **Schedule XI** on a quarterly basis, till at least ninety five per cent. of the proceeds of the issue, excluding the proceeds raised for general corporate purposes, have been utilised.

(3) The board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency as specified in **Schedule XI**.

(4) The issuer shall, within forty five days from the end of each quarter, publicly disseminate the report of the monitoring agency by uploading the same on its website as well as submitting the same to the stock exchange(s) on which its equity shares are listed.

Public communications, publicity materials, advertisements and research reports

138. All public communication, publicity materials, advertisements and research reports shall comply with provisions of **Schedule IX**.

Issue-related advertisements

139. (1) Subject to the provisions of the Companies Act, 2013, the issuer shall, after registering the red herring prospectus (in case of a book built issue) or prospectus (in case of fixed price issue) with the Registrar of Companies, make a pre-issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

(2) The pre-issue advertisement shall be in the format and shall contain the disclosures specified in **Part A** of **Schedule X**.

Provided that the disclosures in relation to price band or floor price and financial ratios contained therein shall be applicable only where the issuer opts to announce the price band or floor price along with the pre-issue advertisement pursuant to sub-regulation (4) of regulation 127.

(3) The issuer may release advertisements for issue opening and issue closing, which shall be in the formats specified in **Parts B and C** of **Schedule X.**

(4) During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed or indicating investors' response to the issue.

Opening of the issue

140. (1) Subject to the compliance with the provisions of the Companies Act, 2013, a public issue may be opened within twelve months from the date of issuance of the observations by the Board under sub-regulation (4) of regulation 123; or

Provided that in case of a fast track issue, the issue shall open within the period specifically stipulated under the Companies Act, 2013.

(2) In case of shelf prospectus, the first issue may be opened within three months of issuance of observations by the Board.

(3) The issue shall be opened after at least three working days from the date of registering the red herring prospectus with the Registrar of Companies in case of book built issues and prospectus with the Registrar of Companies in case of fixed price issues.

Minimum subscription

141. (1) The minimum subscription to be received in the issue shall be at least ninety per cent. of the offer through the offer document, except in case of an offer for sale of specified securities.

(2) In the event of non-receipt of minimum subscription referred to in sub-regulation (1), all application monies received shall be refunded to the applicants forthwith, but not later than fifteen days from the closure of the issue.

Period of subscription

142. (1) Except as otherwise provided in these regulations, a further public issue shall be kept open for at least three working days and not more than ten working days.

(2) In case of a revision in the price band, the issuer shall extend the bidding (issue) period disclosed in the red herring prospectus, for a minimum period of three working days, subject to the provisions of sub-regulation (1).

(3) In case of force majeure, banking strike or similar circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding (issue)period disclosed in the red herring prospectus (in case of a book built issue) or the issue period disclosed in the prospectus (in case of a fixed price issue), for a minimum period of three working days, subject to the provisions of sub-regulation(1).

Application and minimum application value

143. (1) A person shall not make an application in the net offer category for a number of specified securities that exceeds the total number of specified securities offered to public.

Provided that the maximum application by non-institutional investors shall not exceed total number of specified securities offered in the issue less total number of specified securities offered in the issue to qualified institutional buyers.

(2) The issuer shall stipulate in the offer document the minimum application size in terms of number of specified securities which shall fall within the range of minimum application value of ten thousand rupees to fifteen thousand rupees.

(3) The issuer shall invite applications in multiples of the minimum application value, an illustration whereof is given in **Part B of Schedule XIV**.

(4) The minimum sum payable on application per specified security shall be at least twenty five per cent. of the issue price:

Provided that in case of an offer for sale, the full issue price for each specified security shall be payable at the time of application.

Explanation: For the purpose of this regulation "minimum application value" shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.

Manner of calls

144. If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrear along with the subscription money already paid on such shares shall be forfeited:

Provided that it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 137.

Allotment procedure and basis of allotment

145. (1) The issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.

(2) The issuer shall not make any allotment in excess of the specified securities offered through the offer document except in case of oversubscription for the purpose of rounding off to make allotment, in consultation with the designated stock exchange.

Provided that in case of oversubscription, an allotment of not more than one per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

(3) The allotment of specified securities to applicants other than retail individual investors and anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed by the issuer:

Provided that value of specified securities allotted to any person, except in case of employees, in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub- regulation (2) of regulation 130, shall not exceed two lakhs rupees.

(4) The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

(5) The authorised employees of the designated stock exchange along with the lead manager(s) and registrars to the issue shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in **Part A of Schedule XIV**.

Allotment, refund and payment of interest

146. (1) The issuer and lead manager(s) shall ensure that specified securities are allotted and/or application monies are refunded or unblocked within such period as maybe specified by the Board.

(2) The lead manager(s) shall ensure that the allotment, credit of dematerialised securities, refunding or unblocking of application monies, as may be applicable, are done electronically.

(3) Where specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated in sub-regulation (1) above, the issuer shall undertake to pay interest at the rate of fifteen per cent. per annum to the investors and within such time as disclosed in the offer document and the lead manager(s) shall ensure the same.

Post-issue Advertisements

147. (1) The lead manager(s) shall ensure that advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the registrar, date of credit of specified securities and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

(2) Details specified in sub regulation (1) shall also be placed on the websites of the stock exchanges.

Post-issue responsibilities of the lead manager(s)

148. (1) The responsibility of the lead manager(s) shall continue until completion of issue process and for any issue related matter thereafter.

(2) The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.

(3) The lead manager(s) shall continue to be responsible for post-issue activities till the applicants have received the securities certificates, credit to their demat account or refund of application monies and the listing agreement is entered into by the issuer with the stock exchange and listing or trading permission is obtained.

(4) The lead manager(s) shall be responsible for and co-ordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from syndicate member(s) or collecting bank branches and or self-certified syndicate banks, processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, credit of the specified securities to the demat accounts of the allottees and unblocking of ASBA accounts/ despatch of refund orders are completed and securities are listed, as applicable.

(5) Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to the Board.

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

(7) In case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information to the Board in respect of underwriters who have failed to meet their underwriting devolvement in the format specified in **Schedule XVIII**.

Release of subscription money

149. (1) The lead manager(s) shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue.

(2) In case the issuer fails to obtain listing or trading permission from the stock exchanges where the specified securities were listed, it shall refund, through verifiable means, the entire monies received within seven days of receipt of intimation from stock exchanges rejecting the application for listing of specified securities and if monies are not repaid within the specified period, the issuer and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent. per annum.

(3) The lead manager(s) shall ensure that the monies received in respect of the issue are released to the issuer in compliance with the provisions of the Section 40 (3) of the Companies Act, 2013, as applicable.

Reporting of transactions by the promoters and promoter group

150. The issuer shall ensure that all transactions in securities by the promoters and promoter group between the date of filing of the draft offer document or offer document, as the case may be, and the date of closure of the issue shall be reported to the stock exchanges, within twenty four hours of such transactions.

Post- issue reports

151. The lead manager(s) shall submit a final post-issue report as specified in **Part A of Schedule XVII**, along with a due diligence certificate as per the format specified in **Form F** of **Schedule V**, within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure of issue.

PART IX: MISCELLANEOUS

Restriction on further capital issues

152. An issuer shall not make any further issue of specified securities in any manner whether by way of public issue, rights issue, preferential issue, qualified institutions placement, issue of bonus shares or otherwise, except pursuant to an employee stock option scheme:

a) in case of a fast track issue, during the period between the date of registering the offer document (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies and the listing of the specified securities offered through the offer document or refund of application monies; or

b) in case of other issues, during the period between the date of filing the draft offer document and the listing of the specified securities offered through the offer document or refund of application nominees;

unless full disclosures regarding the total number of specified securities or amount proposed to be raised from such further issue are made in such draft offer document or offer document, as the case may be.

Price stabilisation through green shoe option

153. (1) An issuer may provide green shoe option for stabilizing the post listing price of its specified securities, subject to the following:

a) the issuer has been authorized, by a resolution passed in the general meeting of shareholders approving the public issue, to allot specified securities to the stabilising agent, if required, on the expiry of the stabilization period;

b) the issuer has appointed a lead manager as a stabilising agent, who shall be responsible for the price stabilization process;

c) prior to filing the draft offer document, the issuer and the stabilizing agent have entered into an agreement, stating all the terms and conditions relating to the green shoe option including fees charged and expenses to be incurred by the stabilising agent for discharging its responsibilities;

d) prior to filing the offer document, the stabilizing agent has entered into an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them in accordance with clause (g) of this sub-regulation, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size (hereinafter referred to as the “over- allotment”), which shall not be in excess of fifteen percent. Of the issue size;

e) subject to clause (d), the lead manager, in consultation with the stabilising agent, shall determine the amount of specified securities to be over-allotted in the public issue;

f) the draft offer document and offer document shall contain all material disclosures about the green shoe option specified in this regard in **Part A** of **Schedule VI**;

g) in case of an initial public offer pre-issue shareholders and promoters and in case of a further public offer pre-issue shareholders holding more than five per cent. specified securities and promoters may lend specified securities to the extent of the proposed over-allotment;

h) the specified securities borrowed shall be in dematerialized form and allocation of these securities shall be made pro-rata to all successful applicants.

(2) For the purpose of stabilization of post-listing price of the specified securities, the stabilising agent shall determine the relevant aspects including the timing of buying such securities, quantity to be bought and the price at which such securities are to be bought from the market.

(3) The stabilisation process shall be available for a period not exceeding thirty days from the date on which trading permission is given by the stock exchanges in respect of the specified securities allotted in the public issue.

(4) The stabilizing agent shall open a special account, distinct from the issue account, with a bank for crediting the monies received from the applicants against the over-allotment and a special account with a depository participant for crediting specified securities to be bought from the market during the stabilisation period out of the monies credited in the special bank account.

(5) The specified securities bought from the market and credited in the special account with the depository participant shall be returned to the promoters or pre-issue shareholders immediately, in any case not later than two working days after the end of the stabilization period.

(6) On expiry of the stabilisation period, if the stabilising agent has not been able to buy specified securities from the market to the extent of such securities over-allotted, the issuer shall allot specified securities at issue price in dematerialized form to the extent of the shortfall to the special account with the depository participant, within five days of the closure of the stabilization period and such specified securities shall be returned to the promoters or pre-issue shareholders by the stabilizing agent in lieu of the specified securities borrowed from them and the account with the depository participant shall be closed thereafter.

(7) The issuer shall make a listing application in respect of the further specified securities allotted under sub-regulation (6), to all the stock exchanges where the specified securities allotted in the public issue are listed and the provisions of Chapter VII shall not be applicable to such allotment.

(8) The stabilizing agent shall remit the monies with respect to the specified securities allotted under sub-regulation (6) to the issuer from the special bank account.

(9) Any monies left in the special bank account after remittance of monies to the issuer under sub-regulation (8) and deduction of expenses incurred by the stabilizing agent for the stabilisation process shall be transferred to the Investor Protection and Education Fund established by the Board and the special bank account shall be closed soon thereafter.

(10) The stabilizing agent shall submit a report to the stock exchange on a daily basis during the stabilization period and a final report to the Board in the format specified in **Schedule XV**.

(11) The stabilizing agent shall maintain a register for a period of at least three years from the date of the end of the stabilization period and such register shall contain the following particulars:

a) The names of the promoters or pre-issue shareholders from whom the specified securities were borrowed and the number of specified securities borrowed from each of them;

b) The price, date and time in respect of each transaction effected in the course of the stabilization process; and

c) The details of allotment made by the issuer on expiry of the stabilization process.

Alteration of rights of holders of specified securities

154. An issuer shall not alter the terms, including the terms of issue, of specified securities which may adversely affect the interests of the holders of that specified securities, except with the consent in writing of the holders of not less than three-fourths of the specified securities of that class or with the sanction of a special resolution passed at a meeting of the holders of the specified securities of that class.

PART X: FAST TRACK FURTHER PUBLIC OFFER

Eligibility conditions

155. Sub-regulations (1), (2), (3), (4) and (5) and (9) of regulation 123 shall not apply if the issuer satisfies the following conditions for making a further public offer through the fast track route:

a) equity shares of the issuer have been listed on any stock exchange for a period of at least three years immediately preceding the reference date;

b) entire shareholding of the promoter group of the issuer is held in dematerialised form on the reference date

c) average market capitalisation of public shareholding of the issuer is at least one thousand crore rupees in case of public issue;

"average market capitalisation of public shareholding" means the sum of daily market capitalisation of public shareholding for a period of one year up to the end of the quarter preceding the month in which the proposed issue was approved by the shareholders or the board of the issuer, as the case may be, divided by the number of trading days.

"public shareholding" shall have the same meaning as assigned to it under the Securities Contracts (Regulation) Rules, 1957.

d) annualised trading turnover of the equity shares of the issuer during six calendar months immediately preceding the month of the reference date has been at least two per cent. of the weighted average number of equity shares listed during such six months' period:

Provided that for issuers, whose public shareholding is less than fifteen per cent of its issued equity capital, the annualised trading turnover of its equity shares has been at least two per cent. of the weighted average number of equity shares available as free float during such six months' period;

e) annualized delivery-based trading turnover of the equity shares during six calendar months immediately preceding the month of the reference date has been at least ten per cent. of the annualised trading turnover of the equity shares during such six months‘ period;

f) issuer has been in compliance with the equity listing agreement or the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, as applicable, for a period of at least three years immediately preceding the reference date:

Provided that if the issuer has not complied with the provisions of the listing agreement or the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, as applicable, relating to composition of board of directors, for any quarter during the last three years immediately preceding the reference date, but is compliant with such provisions at the time of filing of letter of offer, and adequate disclosures are made in the letter of offer about such non-compliances during the three years immediately preceding the reference date, it shall be deemed as compliance with the condition;

Provided further that imposition of only monetary fines by stock exchanges on the issuer shall not be a ground for ineligibility for undertaking issuances under this regulation;

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

h) no show-cause notices have been issued or prosecution proceedings have been initiated by the Board and pending against the issuer or its promoters or whole-time directors as on the reference date;

i) issuer or promoter or promoter group or director of the issuer has not settled any alleged violation of securities laws through the consent or settlement mechanism with the Board during three years immediately preceding the reference date;

j) equity shares of the issuer have not been suspended from trading as a disciplinary measure during last three years immediately preceding the reference date;

k) there shall be no conflict of interest between the lead manager(s) and the issuer or its group companies in accordance with the applicable regulations.

l) impact of audit qualifications, if any and where quantifiable, on the audited accounts of the issuer in respect of those financial years for which such accounts are disclosed in the letter of offer does not exceed five per cent. of the net profit or loss after tax of the issuer for the respective years.

Submission of offer document and due diligence certificate

156. (1) The issuer shall file the offer document with the Board and the stock exchanges in accordance with sub-regulations (7) and (8) of regulation 123 and shall pay fees to the Board as specified in **Schedule III**.

(2) The lead manager(s) shall submit to the Board, the following documents along with the offer document:

a) a due diligence certificate as per **Form A** of **Schedule V** including additional confirmations as specified in **Form E of Schedule V**;

b) in case of a fast track issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per **Form B** of **Schedule V.**

Explanation: For the purposes of this regulation: "reference date" means the date of registering the red herring prospectus (in case of a book built issue) or prospectus (in case of a fixed price issue) with the Registrar of Companies.

Post-listing exit opportunity for dissenting shareholders

157. In case of further public offers, including under the fast track route**,** the promoters or shareholders in control of an issuer shall provide an exit offer to dissenting shareholders as provided for in the Companies Act, 2013, in case of change in objects or variation in the terms of contract related to objects referred to in the offer document as per conditions and manner is provided in **Schedule XX**;

Provided that the exit offer shall not apply where there are neither identifiable promoters nor shareholders in control of the listed issuer.

CHAPTER V

PREFERENTIAL ISSUE

Provisions of this chapter not to apply in certain cases

158. (1) The provisions of this Chapter shall not apply where the preferential issue of equity shares is made pursuant to:

a) conversion of a loan or an option attached to convertible debt instruments in terms of sub-sections (3) and (4) of sections 81 of the Companies Act, 1956 or sub-section (3) and (4) of section 62 of the Companies Act, 2013, whichever is applicable;

b) a scheme approved by a High Court under section 391 to 394 of the Companies Act, 1956 or approved by a tribunal or the Central Government under sections 230 to 234 of the Companies Act, 2013, as applicable;

Provided that the pricing provisions of this Chapter shall apply to the issuance of shares under schemes mentioned in clause (b) in case of allotment of shares only to a select group of shareholders or shareholders of unlisted companies pursuant to such schemes;

c) a qualified institutions placement in accordance with Chapter VI of these regulations.

(2) The provisions of this Chapter, except the lock-in provisions, shall not apply where the preferential issue of specified securities is made in terms of the rehabilitation scheme approved by the Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985 [1 of 1986] or the resolution plan approved under Section 31 of the Insolvency & Bankruptcy Code, 2016 [No. 31 of 2016], whichever is applicable.

(3) The provisions of this Chapter relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (51 of 1993).

(4) The provisions of regulation 163 and sub-regulations (1), (2), (3) and (4) of regulation 164 shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where the Board has granted relaxation to the issuer in terms of regulation 11 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, if adequate disclosures about the plan and process proposed to be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of the shareholders.

(5) The provisions of sub-regulation (1) of regulation 159 and sub-regulation (6) of regulation 167 shall not apply to a preferential issue of specified securities where the proposed allottee is a mutual fund registered with the Board or insurance company registered with Insurance Regulatory and Development Authority of India or a scheduled commercial bank or a public financial institution.

(6) The provisions of this Chapter shall not apply where the preferential issue of specified securities is made to the lenders pursuant to conversion of their debt, as part of a debt restructuring implemented in accordance with the guidelines specified by the Reserve Bank of India, subject to the following conditions:

a) guidelines for determining the conversion price have been specified by the Reserve Bank of India in accordance with which the conversion price shall be determined and which shall be in compliance with the applicable provisions of the Companies Act,2013;

b) conversion price shall be certified by two independent valuers;

c) specified securities so allotted shall be locked-in for a period of one year from the date of their allotment

Provided that for the purpose of transferring the control, the lenders may transfer the specified securities allotted to them before completion of the lock-in period subject to continuation of the lock-in on such securities for the remaining period, with the transferee;

d) the lock-in of equity shares allotted pursuant to conversion of convertible securities issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in;

e) the applicable provisions of the Companies Act, 2013 are complied with, including the requirement of a special resolution.

PART I: ISSUERS INELIGIBLE TO MAKE A PREFERENTIAL ISSUE

159. (1) Preferential issue of specified securities shall not be made to any person who has sold or transferred any equity shares of the issuer during the six months preceding the relevant date:

Provided that in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation in terms of sub-regulation (2) of regulation 11of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 to such a preferential allotment.

Explanation: Where any person belonging to promoter(s) or the promoter group has sold/ transferred their equity shares in the issuer during the six months preceding the relevant date, the promoter(s) and promoter group shall be ineligible for allotment of specified securities on preferential basis.

Provided that the above restriction shall not apply to any sale of equity shares by any person belonging to promoter(s) of the promoter group which qualifies for inter-se transfer amongst qualifying persons under clause (a) of sub-regulation (1) of regulation 10 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover Regulations), 2011 or in case of transfer of shares held by the promoters or promoter group on account of invocation of pledge by a scheduled commercial bank or public financial institution or a systemically important non- banking finance company or mutual fund or insurance company registered with the Insurance Regulatory and Development Authority.

(2) Where any person belonging to promoter(s) or the promoter group has previously subscribed to warrants of an issuer but has failed to exercise the warrants, the promoter(s) and promoter group shall be ineligible for issue of specified securities of such issuer on preferential basis for a period of one year from:

a) the date of expiry of the tenure of the warrants due to non-exercise of the option to convert; or

b) the date of cancellation of the warrants, as the case maybe.

(3) An issuer shall not be eligible to make a preferential issue if any of its promoters or directors is a fugitive economic offender.

PART II: CONDITIONS FOR PREFERENTIAL ISSUE

Conditions for preferential issue

160. A listed issuer making a preferential issue of specified securities shall ensure that:

a) all equity shares allotted by way of preferential issue shall be made fully paid up at the time of the allotment;

b) a special resolution has been passed by its shareholders;

c) all equity shares held by the proposed allottees in the issuer are in dematerialized form;

d) the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the stock exchange where the equity shares of the issuer are listed and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements), 2015, as amended, and any circular or notification issued by the Board there under;

e) the issuer has obtained the Permanent Account Numbers of the proposed allottees, except those allottees which may be exempt from specifying their Permanent Account Number for transacting in the securities market by the Board.

Relevant date

161. For the purpose of this Chapter, "relevant date" means:

a) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of a preferential issue of specified securities pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016, the date of approval of the corporate debt restructuring package or resolution plan shall be the relevant date.

b) in case of a preferential issue of convertible securities, either the relevant date referred to in clause (a) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

Explanation: Where the relevant date falls on a weekend or a holiday, the day preceding the weekend or the holiday will be reckoned to be the relevant date

Tenure of convertible securities

162. The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.

PART III: DISCLOSURES TO SHAREHOLDERS

163. (1) The issuer shall, in addition to the disclosures required under the Companies Act, 2013 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing the special resolution:

a) objects of the preferential issue;

b) maximum number of specified securities to be issued;

c) intent of the promoters, directors or key managerial personnel of the issuer to subscribe to the offer;

d) shareholding pattern of the issuer before and after the preferential issue;

e) time frame within which the preferential issue shall be completed;

f) identity of the natural persons who are the ultimate beneficial owners of the shares proposed to be allotted and/or who ultimately control the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue:

Provided that if there is any listed company, mutual fund, scheduled commercial bank, insurance company registered with the Insurance Regulatory and Development Authority of India in the chain of ownership of the proposed allottee, no further disclosure will be necessary.

Explanation: For the purpose of identification of the ultimate beneficial owners of the allottees, where the allottees are institutions/entities, the identification of such ultimate beneficial owners, shall be in accordance with the guidelines prescribed by the Board, if any.

g) undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;

h) undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked- in till the time such amount is paid by the allottees.

i) disclosures specified in **Schedule VI**, if the issuer or any of its promoters or directors is a willful defaulter.

(2) The issuer shall place a copy of the certificate of its statutory auditors before the general meeting of the shareholders considering the proposed preferential issue, certifying that the issue is being made in accordance with the requirements of these regulations.

(3) Where the specified securities are issued on a preferential basis for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent valuer, which shall be submitted to the stock exchanges where the equity shares of the issuer are listed:

Provided that if the stock exchange(s) is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may seek any information, as deemed necessary, from the issuer.

(4) The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated.

PART IV: PRICING

Pricing of frequently traded shares

164. (1) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of twenty six weeks or more as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than higher of the following:

a) the average of the weekly high and low of the volume weighted average price of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date; or

b) the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(2) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than twenty six weeks as on the relevant date, the price of the equity shares to be allotted pursuant to the preferential issue shall be not less than the higher of the following:

a) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of compromise, arrangement and amalgamation under sections 391 to 394 of the Companies Act, 1956 or sections 230 to 234 the Companies Act, 2013, as applicable, pursuant to which the equity shares of the issuer were listed, as the case may be;or

b) the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during the period the equity shares have been listed preceding the relevant date; or

c) the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(3) Where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of twenty six weeks from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on the recognised stock exchange during these twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

(4) A preferential issue of specified securities to qualified institutional buyers, not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the volume weighted average prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(5) For the purpose of this Chapter, "frequently traded shares" means the shares of the issuer, in

which the traded turnover on any recognised stock exchange during the twelve calendar months preceding the relevant date, is at least ten per cent of the total number of shares of such class of shares of the issuer:

Provided that where the share capital of a particular class of shares of the issuer is not identical throughout such period, the weighted average number of total shares of such class of the issuer shall represent the total number of shares.

Explanation: For the purpose of this regulation, 'stock exchange' means any of the recognised stock exchange(s) in which the equity shares of the issuer are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding twenty six weeks prior to the relevant date.

Pricing of infrequently traded shares

165. Where the shares of an issuer are not frequently traded, the price determined by the issuer shall take into account the valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies:

Provided that the issuer shall submit a certificate stating that the issuer is in compliance of this regulation, obtained from an independent valuer to the stock exchange where the equity shares of the issuer are listed.

Adjustments in pricing - Frequently and Infrequently traded shares

166. The price determined for a preferential issue in accordance with regulation 164 or regulation 165, shall be subject to appropriate adjustments, if the issuer:

a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;

b) makes an issue of equity shares after completion of a demerger wherein the securities of the resultant demerged entity are listed on a stock exchange;

c) makes a rights issue of equity shares;

d) consolidates its outstanding equity shares into a smaller number of shares;

e) divides its outstanding equity shares including by way of stock split;

f) re-classifies any of its equity shares into other securities of the issuer;

g) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, require adjustments.

PART V: LOCK-IN AND RESTRICTIONS ON TRANSFERABILITY

Lock-in

167. (1) The specified securities, allotted on a preferential basis to the promoters or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on a preferential basis to the promoters or the promoter group, shall be locked-in for a period of three years from the date of trading approval granted for the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case maybe:

Provided that not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of trading approval:

Provided further that equity shares allotted in excess of the twenty per cent shall be locked-in for one year from the date of trading approval pursuant to exercise of options or otherwise, as the case may be.

Provided further that in case of convertible securities or warrants which are not listed on stock exchanges, such securities shall be locked in for a period of one year from the date of allotment.

(2) The specified securities allotted on a preferential basis to persons other than the promoters and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked-in for a period of one year from the date of trading approval.

Provided that in case of convertible securities or warrants which are not listed on stock exchanges, such securities shall be locked in for a period of one year from the date of allotment.

(3) Lock-in of the equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.

(4) The equity shares issued on a preferential basis pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016, shall be locked-in for a period of one year from the trading approval:

(5) If the amount payable by the allottee, in case of re-calculation of price under sub-regulation (3) of regulation 164 is not paid till the expiry of lock-in period, the equity shares shall continue to be locked-in till such amount is paid by the allottee.

(6) The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date up to a period of six months from the date of trading approval:

Provided that in case of convertible securities or warrants which are not listed on stock exchanges, the entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date up to a period of six months from the date of allotment of such securities.

Explanation 1: For the purpose of this regulation:

(I) The expression "total capital of the issuer" means:

a) equity share capital issued by way of public issue or rights issue including equity shares issued pursuant to conversion of specified securities which are convertible; and

b) specified securities issued on a preferential basis to the promoters or the promoters group.

(II) For the computation of twenty per cent. of the total capital of the issuer, the amount of minimum promoters' contribution held and locked-in, in the past in terms of Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 or these regulations shall be taken into account.

(III) The minimum promoters' contribution shall not be put under fresh lock-in again, even though it is considered for computing the requirement of twenty per cent. of the total capital of the issuer, in case the said minimum promoters' contribution is free of lock-in at the time of the preferential issue.

Explanation 2: For the purposes of this regulation, the date of trading approval shall mean the latest date when trading approval has been granted by all the stock exchanges where the equity shares of the issuer are listed, for specified securities allotted as per the provisions of this Chapter.

Transferability

168. (1) Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 2011, specified securities held by promoters and locked-in in terms of sub-regulation (1) of regulation 167, may be transferred among the promoters or the promoter group or to a new promoter or persons in control of the issuer:

Provided that the lock-in on such specified securities shall continue for the remaining period with the transferee.

(2) The specified securities allotted on a preferential basis shall not be transferable by the allottees till the trading approval is granted for such securities by all the recognised stock exchanges where the equity shares of the issuer are listed.

PART VI: CONSIDERATION AND ALLOTMENT

Payment of consideration

169. (1) Full consideration of specified securities other than warrants, shall be paid by the allottees at the time of allotment of such specified securities except in case of shares issued for consideration other than cash.

Provided that in case of a preferential issue of specified securities pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016, the consideration may be in terms of such scheme.

(2) In the case of warrants, an amount equivalent to at least twenty five per cent. of the consideration determined in terms of regulation 164 shall be paid against each warrant on the date of allotment of

warrants and the balance seventy five per cent. of the consideration shall be paid at the time of allotment of the equity shares pursuant to exercise of options against each such warrant by the warrant holder.

Provided that in case the exercise price of the warrants is based on the formula, at least twenty-five per cent. of the consideration amount calculated as per the formula with conversion date being the relevant date shall be paid against each warrant on the date of allotment of warrants and the balance consideration shall be paid at the time of allotment of the equity shares pursuant to exercise of options against each such warrant by the warrant holder.

(3) In case the warrant holder does not exercise the option for equity shares against any of the warrants held by the warrant holder, the consideration paid in respect of such warrant in terms of sub-regulation (2) shall be forfeited by the issuer.

(4) The issuer shall ensure that the consideration of specified securities, if paid in cash, shall be received from respective allottee's bank account and in the case of joint holders, shall be received from the bank account of the person whose name appears first in the application.

(5) The issuer shall submit a certificate from the statutory auditors to the stock exchanges where the equity shares of the issuer are listed stating that the issuer is in compliance of sub-regulation (4) and the relevant documents thereof are maintained by the issuer as on the date of certification.

Allotment

170. (1) Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution:

Provided that where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of the order on such application or the date of approval or permission, as the case may be:

Provided further that where the Board has granted relaxation to the issuer in terms of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the Board in its order granting the relaxation:

Provided further that requirement of allotment within fifteen days shall not apply to allotment of specified securities on preferential basis pursuant to any resolution of stressed assets under a framework specified by the Reserve Bank of India or a resolution plan approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code 2016.

(2) If the allotment of the specified securities is not completed within fifteen days from the date of special resolution, a fresh special resolution shall be passed and the relevant date for determining the price of specified securities under this Chapter shall be taken with reference to the date of the latter special resolution.

(3) Notwithstanding anything contained in this regulation, where a preferential allotment is made that attracts an obligation to make an open offer for shares of the issuer under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011, and there is no offer made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011, the period of fifteen days shall be considered from the expiry of the period specified in sub-regulation (1) of regulation 20 or date of receipt of all statutory approvals required for the completion of an open offer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011:

Provided that if an offer is made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011, the period of fifteen days shall be counted from the expiry of the offer period as defined in the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011:

Provided further that the provisions of this sub-regulation shall not apply to an offer made under sub-regulation (1) of regulation 20 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011, pursuant to a preferential allotment."

(4) Allotment of the specified securities shall be made only in dematerialised form.

Explanation: The requirement of allotment in dematerialised form shall also be applicable for the equity shares to be allotted pursuant to exercise of option attached to warrant or conversion of convertible securities.

CHAPTER VI

QUALIFIED INSTITUTIONS PLACEMENT

Definitions

171. For the purpose of this Chapter:

a) "eligible securities" include equity shares, non-convertible debt instruments along with warrants and convertible securities other than warrants;

b) "relevant date "means:

i. in case of allotment of equity shares, the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorized by the board of directors of the issuer decides to open the proposed issue;

ii. in case of allotment of eligible convertible securities, either the date of the meeting in which the board of directors of the issuer or the committee of directors duly authorised by the board of directors of the issuer decides to open the issue of such convertible securities or the date on which the holders of such convertible securities become entitled to apply for the equity shares.

PART I: CONDITIONS FOR QUALIFIED INSTITUTIONS PLACEMENT

Eligibility conditions

172. (1) A listed issuer may make a qualified institutions placement of eligible securities if it satisfies the following conditions:

a) a special resolution approving the qualified institutions placement has been passed by its shareholders, and the special resolution shall, among other relevant matters, specify that the allotment is proposed to be made through qualified institutions placement and the relevant date referred to in sub-clause (ii) of clause (b) of regulation171;

Provided that no shareholders' resolution will be required in case the qualified institutions placement is through an offer for sale by promoters or promoter group for compliance with minimum public shareholding requirements specified in the Securities Contracts (Regulation) Rules, 1957;

Provided further that allotment pursuant to the special resolution referred to in this clause (a) of regulation 172 shall be completed within a period of 365 days from the date of passing of the resolution.

b) the equity shares of the same class, which are proposed to be allotted through qualified institutions placement or pursuant to conversion or exchange of eligible securities offered through qualified institutions placement, have been listed on a stock exchange for a period of at least one year prior to the date of issuance of notice to its shareholders for convening the meeting to pass the special resolution:

Provided that where an issuer, being a transferee company in a scheme of compromise, arrangement and amalgamation sanctioned by a High Court under sections 391-394 of the Companies Act, 1956 or approved by a tribunal or the Central Government under sections 230 to 234 of the Companies Act, 2013, whichever is applicable makes qualified institutions placement, the period for which the equity shares of the same class of the transferor company were listed on a stock exchange having nation-wide trading terminals shall also be considered for the purpose of computation of the period of one year.

Provided further that this clause shall not be applicable to an issuer proposing to undertake qualified institutional placement for complying with the minimum public shareholding requirements specified in the Securities Contracts (Regulation) 1957.

Explanation: For the purpose of clause (b), "equity shares of the same class" shall mean equity shares which rank pari passu in relation to rights as to dividend, voting or otherwise.

c) An issuer shall be eligible to make a qualified institutions placement if any of its promoters or directors is not a fugitive economic offender.

(2) All eligible securities issued through a qualified institutions placement shall be listed on the recognized stock exchange where the equity shares of the issuer are listed.

Provided that the issuer shall seek approval under rule 19(7) of the Securities Contracts (Regulation) Rules, 1957, if applicable.

(3) The issuer shall not make any subsequent qualified institutions placement until the expiry of six months from the date of the prior qualified institutions placement made pursuant to one or more special resolutions.

Conditions for offer for sale by promoters for compliance with minimum public shareholding requirements specified in the Securities Contracts (Regulation) Rules, 1957

173. The promoters and members of the promoter group may make an offer for sale of fully paid up equity shares, through a qualified institutions placement, for the purpose of achieving minimum public shareholding in terms of the Securities Contracts (Regulation) Rules, 1957.

Provided that the promoters or members of the promoter group shall not make such offer for sale if the promoter or member of the promoter group has purchased or sold any equity shares of the issuer during twelve weeks period prior to the date of the opening of the issue and they shall not purchase or sell any equity shares of the issuer during the twelve weeks period after the date of closure of the issue:

Provided further that such promoters or members of the promoter group may, within the twelve week periods provided above, sell equity shares of the issuer held by them through offer for sale through stock exchange mechanism specified by the Board or through an open market sale, in accordance with the conditions specified by the Board from time to time, subject to the condition that there shall be agapof minimum two weeks between the two successive offer(s).

PART II: APPOINTMENT OF LEAD MANAGERS

174. (1) An issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue.

(2) At least one lead manager to the issue shall not be an associate (as defined under the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992) of the issuer and if any of the lead manager is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to marketing of the issue.

(3) The lead manager(s) shall, while seeking in-principle listing approval for the eligible securities, furnish to each stock exchange on which the same class of equity shares of the issuer are listed, a due diligence certificate stating that the eligible securities are being issued under qualified institutions placement and that the issuer complies with requirements of this Chapter, and also furnish a copy of the preliminary placement document along with any other document required by the stock exchange.

PART III: PLACEMENT DOCUMENT

175. (1) The lead manager(s) shall exercise due diligence and shall satisfy themselves with all aspects of the Issue including the veracity and adequacy of disclosures in the offer document.

(2) The qualified institutions placement shall be made on the basis of a placement document which shall contain all material information, including those specified in the Companies Act, 2013, if any, and disclosures as specified in **Schedule VII** shall be made, including as specified therein if the issuer or any of its promoters or directors is a willful defaulter.

(3) The preliminary placement document and the placement document shall be serially numbered and copies the same shall be circulated only to select investors.

(4) The preliminary placement document and the placement document shall be placed on the websites of the relevant stock exchange(s) and of the issuer with a disclaimer to the effect that it is in connection with a qualified institutions placement and that no offer is being made to the public or to any other category of investors.

PART IV: PRICING

176. (1) The qualified institutions placement shall be made at a price not less than the average of the weekly high and low of the closing prices of the equity shares of the same class quoted on the stock exchange during the two weeks preceding the relevant date:

Provided that the issuer may offer a discount of not more than five per cent on the price so calculated, subject to approval of shareholders as specified in clause (a) of regulation 172 of these regulations, except that no shareholders' approval will be required in case of a qualified institutions placement made through an offer for sale by promoters for compliance with minimum public shareholding requirements specified in the Securities Contracts (Regulation) Rules, 1957.

(2) Where eligible securities are convertible into or exchangeable with equity shares of the issuer, the issuer shall determine the price of such equity shares allotted pursuant to such conversion or exchange taking the relevant date as disclosed in the special resolution referred to in clause (a) of sub regulation (1) of regulation172.

(3) The issuer shall not issue or allot partly paid-up eligible securities:

Provided that in case of allotment of non-convertible debt instruments along with warrants, the allottees may pay the full consideration or part there of payable with respect to warrants at the time of allotment of such warrants:

Provided further that on allotment of equity shares on exercise of options attached to warrants, such equity shares shall be fully paid-up.

(4) The issue price shall be subject to appropriate adjustments, if the issuer:

a) makes an issue of equity shares by way of capitalization of profits or reserves, other than by way of a dividend on shares;

b) makes a rights issue of equity shares;

c) consolidates its outstanding equity shares into a smaller number of shares;

d) divides its outstanding equity shares including by way of stock split;

e) re-classifies any of its equity shares in too the r securities of the issuer;

f) is involved in such other similar events or circumstances, which in the opinion of the concerned stock exchange, requires adjustments.

Explanation: For the purpose of sub-regulation (1), the term “stock exchange” means any of the recognized stock exchanges in which the equity shares of the same class of the issuer are listed and in which the highest trading volume in such equity shares has been recorded during the two weeks immediately preceding the relevant date.

PART V: TENURE OF CONVERTIBLE SECURITIES

177. The tenure of the convertible or exchangeable eligible securities issued through qualified institutions placement shall not exceed sixty months from the date of allotment.

PART VI: TRANSFERABILITY

178. The eligible securities allotted under the qualified institutions placement shall not be sold by the allottee for a period of one year from the date of allotment, except on a recognized stock exchange.

PART VII: APPLICATION AND ALLOTMENT

179. (1) The applicants in qualified institutions placement shall not withdraw or revise downwards their bids after the closure of the issue.

(2) Allotment of specified securities shall be made subject to the following conditions:

a) minimum of ten per cent of eligible securities shall be allotted to mutual funds:

Provided that any unsubscribed portion of the said minimum percentage or any part thereof may be allotted to other qualified institutional buyers;

b) no allotment shall be made, either directly or indirectly, to any qualified institutional buyer who is a promoter or any person related to the promoters of the issuer:

Provided that a qualified institutional buyer who does not hold any shares in the issuer and who has acquired the said rights in the capacity of a lender shall not be deemed to be a person related to the promoters.

Explanation: For the purpose of this clause, a qualified institutional buyer who has any of the following rights shall be deemed to be a person related to the promoters of the issuer:-

a) rights under a shareholders‘ agreement or voting agreement entered into with promoters or promoter group;

b) veto rights; or

c) right to appoint any nominee director on the board of the issuer.

(3) In a qualified institutions placement of non-convertible debt instrument along with warrants, an investor can subscribe to the combined offering of non-convertible debt instruments with warrants or to the individual securities, that is, either non- convertible debt instruments or warrants.

Minimum number of allottees

180. (1) The minimum number of allottees for each placement of eligible securities made under this Chapter shall at least be:

a) two, where the issue size is less than or equal to two hundred and fifty crore rupees;

b) five, where the issue size is greater than two hundred and fifty crore rupees:

Provided that no single allottee shall be allotted more than fifty per cent. Of the issue size.

(2) Qualified institutional buyers belonging to the same group or who are under same control shall be deemed to be a single allottee.

Explanation: For the purpose of sub-regulation (2), the expression “qualified institutional buyers belonging to the same group” shall mean entities where, **-** (i) any of them controls directly or indirectly, through its subsidiary or holding company, not less than fifteen per cent. of the voting rights in the other; or (ii) any of them directly or indirectly, by itself, or in combination with other persons exercise control over the others; or (iii) there is a common director, excluding nominee and independent directors amongst the investor, its subsidiary or holding company and any other investor.

CHAPTER VII

INITIAL PUBLIC OFFER OF INDIAN DEPOSITORY RECEIPTS APPLICABILITY

Applicability

181. The provisions of this Chapter shall apply to an issue of Indian Depository Receipts (hereinafter referred to as “IDR”) made in terms of the Companies Act, 2013 and Companies (Registration of Foreign Companies) Rules,2014.

PART I: ELIGIBILITY REQUIREMENTS

Reference date

182. Unless otherwise provided in this Chapter, an issuer making a public issue of IDRs shall satisfy the conditions of this Chapter as on the date of filing draft offer document with the Board and also as on the date of registering the offer document with the Registrar of Companies.

Eligibility conditions

183. (1) An issuer shall be eligible to make an issue of IDRs only if:

a) the issuing company is listed in its home country for at least three immediately preceding years;

b) the issuer is not prohibited to issue securities by any regulatory body;

c) the issuer has a track record of compliance with the securities market regulations in its home country;

d) any of its promoters or directors is not a fugitive economic offender.

Explanation: For the purpose of this regulation, the term "home country" means the country where the issuer is incorporated and listed.

(2) The issue shall be subject to the following conditions:

a) issue size shall not be less than fifty crore rupees;

b) at any given time, there shall be only one denomination of IDRs of the issuer.

c) issuer shall ensure that the underlying equity shares against which IDRs are issued have been or will be listed in its home country before listing of IDRs in stock exchange(s).

d) issuer shall ensure that the underlying shares of IDRs shall rank pari passu with the existing shares of the same class.

(3) The issuer shall ensure that:

a) it has made an application to one or more stock exchanges to seek an in-principle approval for listing of the IDRs on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of **Schedule XIX**;

b) it has entered into an agreement with a depository for dematerialisation of the IDRs proposed to be issued;

c) it has made firm arrangements of finance through verifiable means towards seventy five per cent. of the stated means of finance for the project proposed to be funded from issue proceeds, excluding the amount to be raised through the proposed issue of IDRs or through existing identifiable internal accruals, have been made.

(4) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed twenty five per cent. of the amount being raised by the issuer.

PART II: APPOINTMENT OF LEAD MANAGERS, OTHER INTERMEDIARIES AND COMPLIANCE OFFICER

184. (1) The issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue and shall also appoint other intermediaries, in consultation with the lead manager and shall enter into an agreement with the lead manager on the lines of format of agreement as specified in **Schedule II**.

(2) Where the issue is managed by more than one lead manager, the rights, obligations and responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each lead manager shall be predetermined and be disclosed in the draft offer document and the offer documents as specified in **Schedule I**.

(3) At least one lead manager to the issue shall not be an associate (as defined under the Securities and Exchange Board of India (Merchant Bankers) Regulations,1992) of the issuer and if any of the lead manager(s) is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to marketing of the issue.

(4) The issuer shall appoint a registrar to the issue, registered with the Board, which has connectivity with all the depositories.

(5) The issuer shall enter into an agreement with an overseas custodian bank and a domestic depository.

(6) The issuing company shall make arrangements for collection at centres as specified in **Schedule XII**.

(7) The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

PART IV: DISCLOSURES IN AND FILING OF OFFER DOCUMENTS

Disclosures in the draft offer document and offer document

185. (1) The offer document shall contain all material disclosures which are true, correct and adequate to enable the applicants to take an informed investment decision.

(2) Without prejudice to the generality of sub-regulation (1), the offer document shall contain:

a) disclosures specified in the Companies (Registration of Foreign Companies) Rules, 2014; and

b) disclosures in the manner as specified in **Part A** of **Schedule VIII.**

(3) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer documents.

(4) The lead manager(s) shall call upon the issuer, its promoters or directors to fulfill their obligations as disclosed by them in the draft offer document or offer document, as the case may be, and as required in terms of these Regulations.

Filing of the draft offer document and offer document

186. (1) Prior to making an initial public offer, the issuer shall file three copies of the draft offer document with the Board, in accordance with **Schedule IV**, along with fees as specified in **Schedule III**, through the lead manager(s).

(2) The draft offer document and the offer documents filed with the Board shall also be furnished to the Board in a soft copy.

(3) The lead manager(s)shall:

a) submit a certificate confirming that an agreement has been entered into between the issuer and the lead manager(s)

b) submit a due diligence certificate as per format given in **Part H** of **Schedule V** to the Board along with the draft offer document**;**

c) certify that all amendments, suggestions or observations made by the Board have been incorporated in the offer document;

d) submit a due diligence certificate as per format given in **Part C** of **Schedule V**, at the time of filing the offer document with the Registrar of the Companies.

e) a due diligence certificate as per **Form D** of **Schedule V**, in the event the issuer has made a disclosure of any material development by issuing a public notice.

(4) The issuer shall, before filing the offer document with the Registrar of Companies, file with the Board through the lead manager(s), an updated draft offer document highlighting all changes made in the draft offer document.

(5) If there are any changes in the draft offer document in relation to the matters specified in **Schedule XVI**, an updated offer document or a fresh draft offer document, as the case may be, shall be filed with the Board along with fees specified in **Schedule III**.

(6) Copy of the offer documents shall also be filed with the Board and the stock exchange(s) through the lead manager(s) promptly after registering the offer documents with the registrar of companies.

Draft offer document and offer document to be available to the public

187. (1) The draft offer document filed with the Board shall be made public for comments, if any, for a period of at least twenty one days from the date of filing, by hosting it on the websites of the Board, stock exchanges where specified securities are proposed to be listed and lead manager(s) associated with the issue.

(2) The issuer shall, within two days of filing of the draft offer document with the Board, make a public announcement in one English national daily newspaper with wide circulation and one Hindi national daily newspaper with wide circulation, disclosing to the public the fact of filing of the draft offer document with the Board and inviting the public to provide their comments to the Board, the issuer or the lead manager(s) in respect of the disclosures made in the draft offer document.

(3) The lead manager(s) shall, after expiry of the period stipulated in sub-regulation (1), file with the Board, details of the comments received by them or the issuer from the public, on the draft offer document, during that period and the consequential changes, if any, that are required to be made in the draft offer document.

(4) The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the registrar of companies, Board and the stock exchanges, as applicable.

(5) The lead manager(s) and the stock exchanges shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

PART V - PRICING

Pricing

188. (1) The issuer may determine the price of the IDRs in consultation with the lead manager(s) or through the book building process, as the case maybe.

(2) The issuer shall undertake the book building process in a manner specified in **Schedule XIII**.

Price and price band

189. (1) The issuer may mention a price or a price band in the offer document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

(2) The cap on the price band shall be less than or equal to one hundred and twenty per cent of the floor price.

(3) The floor price or the final price shall not be less than the face value of the IDRs.

(4) Where the issuer opts not to make the disclosure of the floor price or price band in the red herring

prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under **Part A of Schedule X.**

(5) The announcement referred to in sub-regulation (4) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" of the offer document.

(6) The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the stock exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the stock exchange(s).

Differential pricing

190. (1) The issuer may offer its IDRs at different prices, subject to the following:

a) Retail individual investors or employees entitled for reservation may be offered specified securities at a price not lower by more than ten per cent. of the price at which net offer is made to other categories of applicants, excluding anchor investors.

Explanation: For the purpose of this Chapter, "employee" shall mean a person who:

i. is a resident of India, and

ii. is a permanent and full-time employee or a director, whether whole time or part time, of the issuer or of the holding company or subsidiary company or of the material associate(s) of the issuer, whose financial statements are consolidated with the issuer's financial statements, working in India and does not include promoters and an immediate relative of the promoter.

b) In case the issuer opts for the alternate method of book building in terms of Part D of **Schedule XIII**, the issuer may offer specified securities to its employees at a price not lower by more than ten per cent. of the floor price.

(2) Discount, if any, shall be expressed in rupee terms in the offer document.

PART VI: ISSUANCE CONDITIONS AND PROCEDURE

Issuance conditions

191. (1) The procedure to be followed by each class of applicant shall be mentioned in the offer document.

(2) The minimum application amount shall be twenty thousand rupees.

Allocation in the issue

192. (1) The allocation in the issue shall be as follows:

a) at least fifty per cent. of the issue shall be allotted to qualified institutional buyers on proportionate basis as per illustration given in **Part A of Schedule XIV**;

b) the remaining portion of the issue may be allocated among the categories of non-institutional investors and retail individual investors including employees, at the discretion of the issuer and the manner of allocation shall be disclosed in the offer document. Allotment to investors within a category shall be on proportionate basis:

Provided that at least thirty per cent of the IDRs being offered in the public issue shall be available for allocation to retail individual investors and in case of under-subscription in retail individual investor category, spill over to other categories to the extent of under subscription may be permitted.

(2) A person shall not make an application in the net offer category for a number of IDRs which exceeds the total number of IDRs offered to the public.

Abridged prospectus

193. (1) The abridged prospectus shall contain the disclosures as specified in **Part B** of **Schedule VIII** and shall not contain any matter extraneous to the contents of the offer document.

(2) Every application form distributed by the issuer or any other person in relation to an issue shall be accompanied by a copy of the abridged prospectus.

ASBA

194. The issuer shall accept bids using only the ASBA facility in the manner specified by the Board.

Availability of issue material

195. The lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, investors' associations and self-certified syndicate banks before the opening of the issue.

Prohibition on payment of incentives

196. Any person connected with the issue shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the initial public offer, except for fees or commission for services rendered in relation to the issue.

Security deposit

197. (1) The issuer shall, before the opening of subscription list, deposit with the designated stock exchange, an amount calculated at the rate of one per cent. of the issue size available for subscription to the public in the manner specified by Board and/or stock exchange(s).

(2) The amount specified in sub-regulation (1) shall be refundable or forfeitable in the manner specified by the Board.

Underwriting

198. (1) If the issuer making an initial public offer of IDRs, other than through the book building process, desires to have the issue underwritten, it shall appoint underwriters in accordance with the Securities and Exchange Board of India (Underwriters) Regulations,1993.

(2) If the issuer makes a public issue through the book building process,

a) The issue shall be underwritten by lead manager(s) and syndicate member(s):

b) The issuer shall, prior to filing the prospectus, enter into underwriting agreement with the lead manager(s), and syndicate member(s), indicating there in the number of specified securities which they shall subscribe to at the predetermined price in the event of under-subscription in the issue.

c) If the syndicate member(s) fail to fulfill their underwriting obligations, the lead manager(s) shall fulfil such underwriting obligations.

d) The lead manager(s) and the syndicate member(s) shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.

e) In case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations,1992.

f) where the issue is required to be underwritten, the underwriting obligations should at least to the extent of minimum subscription.

Public communications, publicity materials, advertisements and research reports

199. All public communication, publicity materials, advertisements and research reports shall comply with the provisions of **Schedule IX**, subject to the following:

a)the applicability of clauses (1) and (7) and Explanation II shall be restricted to any issue advertisements made in India or any research report circulated in India, pertaining to the IDR issue of the issuing company;

b) the applicability of clauses (2) and (3) shall be restricted to any public communications and publicity material issued or published in any media in India;

c) the applicability of clauses (4) and (5) shall be restricted to any material or information released in India and any issue advertisements and publicity materials issued or published in any media in India;

d) the applicability of clause (10) shall be restricted to any product advertisement of the issuer issued or published in any media in India;

e) all other provisions of **Schedule IX** shall be applicable.

Issue-related advertisements

200. (1) The issuer may release advertisements for issue opening and issue closing, which shall be in the formats specified in **Parts B and C of Schedule X.**

(2) During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed or indicating investors' response to the issue.

(3) An announcement regarding closure of the issue shall be made only after the lead manager(s) is satisfied that at least ninety per cent. of the issue has been subscribed and a certificate has been obtained to that effect from the registrar to the issue:

Provided that such an announcement shall not be made before the date on which the issue is to be closed except for issue closing advertisement made in the format prescribed in these regulations.

Opening of the issue

201. (1) Subject to the compliance with the provisions of the Companies Act, 2013, a public issue may be opened:

a) with in twelve months from the date of issuance of the observations by the Board under regulation 6; or

(2) an issue shall be opened after at least three working days from the date of registering the prospectus with the Registrar of Companies.

Minimum subscription

202. (1) The minimum subscription to be received in the issue shall be at least ninety per cent. of the offer through the offer document.

(2) For non-underwritten issues:

a) If the issuer does not receive the minimum subscription of ninety per cent. of the offer through offer document on the date of closure of the issue, or if the subscription level falls below ninety per cent. after the closure of issue, the issuer shall forthwith refund through verifiable means the entire subscription amount received.

b) If the issuer fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

(3) For underwritten issues:

a) If the issuer does not receive the minimum subscription of ninety per cent. of the offer through offer document including devolvement of underwriters, all application monies received shall be refunded through verifiable means to the applicants forthwith, but not later than fifteen days from the closure of the issue.

b) If the issuer fails to refund the entire subscription amount within fifteen days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of fifteen per cent. per annum for the period of delay.

(4) In case of an undersubscribed issue that is underwritten, the lead manager(s) shall furnish information to the Board in respect of underwriters who have failed to meet their underwriting devolvement in the format specified in **Schedule XVIII**.

Period of subscription

203. (1) Except as otherwise provided in these regulations, an initial public offer of IDRs shall be kept open for at least three working days and not more than ten working days.

(2) In case of a revision in the price band, the issuer shall extend the bidding (issue) period disclosed in the red herring prospectus, for a minimum period of three working days, subject to the provisions of sub-regulation (1).

(3) In case of force majeure, banking strike or similar circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding (issue) period disclosed in the red herring prospectus (in case of a book built issue) or the issue period disclosed in the prospectus (in case of a fixed price issue), for a minimum period of three working days, subject to the provisions of sub-regulation (1).

Allotment procedure and basis of allotment

204. (1) The issuer shall not make any allotment in excess of the specified securities offered through the offer document except in case of oversubscription for the purpose of rounding off to make allotment, in consultation with the designated stock exchange.

Provided that in case of oversubscription, an allotment of not more than one per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

(2) The allotment of specified securities to applicants other than retail individual investors shall be on proportionate basis within the respective investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed in the offer document:

Provided that value of specified securities allotted to retail individual investors shall not exceed two lakhs rupees.

(3) The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

(4) The authorised employees of the designated stock exchange, along with the lead manager(s) and registrars to the issue, shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in **Part A of Schedule XIV**.

Allotment, refund and payment of interest

205. (1) The issuer shall ensure that the letters of allotment for the IDRs are issued simultaneously to all allottees and that in the event of it being impossible to issue letters of regret at the same time, a notice to that effect shall be issued in the media so that it appears on the morning after the letters of allotment have been despatched.

(2) The issuer and lead manager(s) shall ensure that the IDRs are allotted and/or application monies are refunded or unblocked within such period as may be specified by the Board.

(3) The lead manager(s) shall ensure that the allotment, credit of dematerialised securities, refunding or unlocking of application monies, as may be applicable, are done electronically.

(4) Where the specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated in sub-regulation (1) above, the issuer shall undertake to pay interest at the rate of fifteen per cent per annum to the investors and within such time as disclosed in the offer document and the lead manager(s) shall ensure the same.

Post-issue advertisements

206. (1) The lead manager(s) shall ensure that advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the registrar, date of credit of the IDRs and date of filing of listing application, etc.is released with in ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation.

(2) Details specified in sub regulation (1) shall also be placed on the websites of the stock exchanges where the securities are listed.

Post-issue responsibilities of the lead manager(s)

207. (1) The responsibility of the lead manager(s) shall continue until completion of the issue process and for any issue related matter thereafter.

(2) The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.

(3) The lead manager(s) shall continue to be responsible for post-issue activities till the applicants have received the credit of IDRs to their account or refund of application monies and the listing agreement is entered into by the issuer with the stock exchange and listing or trading permission is obtained.

(4) The lead manager(s) shall be responsible for and co-ordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from syndicate member(s) or collecting bank branches and/ or self-certified syndicate

banks processing of the applications including application form for ASBA and other matters till the basis of allotment is finalised, credit of the specified securities to the demat accounts of the allottees and unblocking of ASBA accounts/ despatch of refund orders are completed and securities are listed, as applicable.

(5) Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to the Board.

(6) In case there is a devolvement on the underwriters, the lead manager(s) shall ensure that the notice for devolvement containing the obligation of the underwriters is issued within ten days from the date of closure of the issue.

(7) In case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information to the Board in respect of underwriters who have failed to meet their underwriting devolvement in the format specified in **Schedule XVIII**.

Release of subscription money

208. (1) The lead manager(s) shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue**.**

(2) In case the issuer fails to obtain listing or trading permission from the stock exchanges where the specified securities were listed, it shall refund through verifiable means the entire monies received within seven days of receipt of intimation from stock exchanges rejecting the application for listing of IDRs, if any such money is not repaid within eight days after the issuer becomes liable to repay it the issuer and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent. Per annum.

(3) The lead manager(s) shall ensure that the monies received in respect of the issue are released to the issuer in compliance with the provisions of the Section 40 (3) of the Companies Act, 2013, as applicable.

Reporting of transactions by the promoters and promoter group

209. (1) The issuer shall ensure that transactions in securities by the promoters and promoter group during the period between the date of filing of the draft offer document or offer document, as the case may be, and the date of closure of the issue shall be reported to the stock exchange(s) within twenty four hours of such transactions.

Post-issue reports

210. The lead manager(s) shall submit a final post-issue report on the lines of **Parts A** of **Schedule XVII**, along with a due diligence certificate as per the format specified in **Form F** of **Schedule V**, within seven days of the date of finalisation of basis of allotment or within seven days of refund of money in case of failure of issue.

Fungibility

211. The IDRs shall be fungible into the underlying equity shares of the issuer in the manner specified by the Board and Reserve Bank of India, from time to time.

CHAPTER VIII

RIGHTS ISSUE OF INDIAN DEPOSITORY RECEIPTS

Applicability

212. In addition to compliance with Chapter VII, wherever applicable, a listed issuer offering IDRs through a rights issue shall satisfy the conditions specified in this Chapter at the time of filing the offer document:

Provided that the provisions of the following regulations shall not be applicable in case of rights issue of IDRs:

a) regulation191

b) sub-regulation (1) of regulation192

c) clause (a) of sub regulation (2) of regulation183

d) regulation 205; and

e) sub-regulation (2) of regulation185.

Entities not eligible to make a rights issue

213. An issuer shall not be eligible to make a rights issue of IDRs if–

a) at the time of undertaking the rights issue, the issuer is in breach of ongoing material obligations under the listing agreement and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 as may be applicable to such issuer or material obligations under the deposit agreement entered into between the domestic depository and the issuer at the time of initial offering of IDRs;

b) any of its promoters or directors is a fugitive economic offender.

General conditions

214. The issuer shall ensure that it has made an application to all the stock exchanges in India, where its IDRs are already listed, for listing of the IDRs to be issued by way of rights and has chosen one of them as the designated stock exchange, in terms of **Schedule** XIX.

Renunciation by an IDR holder

215. Unless the laws of the home jurisdiction of the issuer otherwise provide, the rights issue shall be deemed to include a right exercisable by the person concerned to renounce the IDRs offered to the IDR holder in favour of any other person subject to applicable laws and the same shall be disclosed in the offer document.

Depository

216. The domestic depository shall, in accordance with the depository agreement executed with the issuer at the time of initial offering of IDR, take such steps as are necessary to enable the IDR holders to have entitlements under the rights offering and issue additional IDRs to such IDR holders, distribute the rights to the IDR holders or renouncees or arrange for the IDR holders or renouncees to subscribe for any additional rights which are available due to lack of take-up by other holders of underlying shares.

Record date

217. (1) An issuer making a rights issue of IDRs shall, in accordance with the provisions of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, the issuer shall announce a record date for the purpose of determining the shareholders eligible to apply for IDRs in the proposed rights issue.

(2) If the issuer withdraws the rights issue after announcing the record date, it shall notify the Board about the same and shall notify the same in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where principal office of the issuer is situated in India. If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for offering of IDRs on a rights basis for a period of twelve months from the said record date.

Disclosures in the offer document and the addendum

218. (1*)* The offer document for the rights offering shall contain disclosures as required under the home country regulations of the issuer.

(2) An additional wrap (addendum to offer document) shall be attached to the offer document to be circulated in India containing information as specified in **Part C** of **Schedule VIII** and other instructions as to the procedures and process to be followed with respect to rights issue of IDRs in India.

(3) Without prejudice to the generality of sub-regulations (1) and (2), the offer document and the addendum attached with it, shall contain all material information, which are true, correct and adequate, so as to enable the applicants to take an informed investment decision.

Appointment of lead managers and compliance officer

219. (1) The issuer shall appoint one or more merchant bankers, which are registered with the Board, as a lead manager(s) to the issue and shall also appoint other intermediaries, in consultation with the lead manager, to carry out the obligations relating to the issue.

(2) The issuer shall ensure that the compliance officer, in charge of ensuring compliance with the obligations under this Chapter, functions from within the territorial limits of India.

Filing of draft offer document and the addendum for rights offering

220. (1) The issuer shall, through the lead manager(s), file the draft offer document prepared in accordance with the home country requirements along with an addendum containing disclosures as specified in **Part C** of **Schedule VIII** with the Board, as a confidential filing accompanied with fees as specified in **Schedule III**.

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

a) the date of receipt of the draft offer document prepared in accordance with the home country requirements along with an addendum under sub-regulation (2); or

b) the date of receipt of satisfactory reply from the lead manager(s), where the Board has sought any clarification or additional information from them; or

c) the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or

d) the date of receipt of a copy of in-principle approval letter issued by the stock exchanges.

(3) If the Board specifies any changes or issues observations on the draft offer document and the addendum under sub-regulation (3), the issuer and the lead manager(s)shall file the revised draft offer document and the updated addendum after incorporating the changes specified by the Board.

(4) The issuer shall also submit an undertaking from the overseas custodian and domestic depository addressed to the issuer, to comply with their obligations with respect to the said rights issue under their respective agreements entered into between them, along with the offer document.

Pricing

221. The issue price and the ratio shall be decided simultaneously with record date in accordance with the home country regulations.

Availability of Issue Material

222. (1) The abridged letter of offer, containing disclosures as specified in Part B of **Schedule** IX, for a rights offering, along with application form, shall be dispatched through registered post or speed post or by courier service or by electronic mode to all the eligible IDR holders at least three days before the date of opening of the issue and shall be made available on the website of the issuer with appropriate access restrictions at the same time it is made available to the holders of its equity shares.

Provided that a hard copy of the offer document for a rights offering along with the addendum shall be made available at the principal office of the issuer or lead manager to any existing IDR holder who has made a request in this regard.

(2) The eligible IDR holders who have not received the application form may apply in writing on a plain paper to the domestic depository, along with the requisite application money within the time frame for acceptance.

(3) The eligible IDR holders making an application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently.

(4) Where any eligible IDR holder makes an application on an application form as well as on plain paper, such application is liable to be rejected.

Issue-related advertisement

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

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

b) the centres other than principal office of the issuer in India where the eligible IDR holders may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;

c) a statement that if the eligible IDR holders have neither received the original application forms nor they are in a position to obtain the duplicate forms, they may make application in writing on a plain paper to subscribe to the rights issue;

d) a format to enable the eligible IDR holders, to make the application on a plain paper specifying therein necessary particulars such as name, address, ratio of rights issue, issue price, number of IDRs held, ledger folio numbers, depository participant ID, client ID, number of IDRs entitled and applied for, amount to be paid along with application, and particulars of cheque, etc. to be drawn in favour of the issuer's account;

e) a statement that the applications can be directly sent by the eligible IDR holders through registered post together with the application monies to the issuer's designated official at the address given in the advertisement;

f) a statement to the effect that if the eligible IDR holder makes an application on plain paper and also on application form both the applications shall be liable to be rejected at the option of the issuer.

(2) The advertisement shall be made in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where principal office of the issuer is situated in India at least three days before the date of opening of the issue.

Period of subscription and issue of allotment letter

224. (1) A rights issue shall be open for subscription in India for a period as applicable under the laws of its home country but in no case less than tendays.

(2) The issuing company shall ensure that it sends the allotment letter of rights to IDR holders at the time these are sent to shareholders of the issuing company as per the requirement of its home country or other jurisdictions where its securities are listed.

Utilisation of funds

225. The issuer shall utilise funds raised in relation to the IDRs pursuant to the rights offering only upon completion of the allotment process.

Fast track issue

226. (1) Nothing contained in sub-regulations (1) of regulation 221, (1), (2) and (3) of regulation 222 shall apply, if the issuer satisfies the following conditions:

a) the issuer is in compliance in all material respects with the provisions of deposit agreement and the provisions of listing agreements (or listing conditions) applicable in all the jurisdictions wherever the issuer is listed, for a period of at least three years immediately preceding the date of filing of the offer document, and a certification to this effect is provided by the issuer;

b) the offer document for the rights offering of the securities of the issuer has been filed and reviewed by the securities regulator in the home country of the issuer;

c) there are no pending show-cause notices or prosecution proceedings against the issuer or its promoters, where applicable, or whole time directors on the reference date by the Board or the regulatory authorities in its home country restricting them from accessing the capital markets; and

d) the issuer has redressed at least ninety five per cent. of the complaints received from the IDR holders before the end of the three months period immediately preceding the month of date of filing the letter of offer with the designated stock exchange.

(2) Where the conditions in sub-regulation (1) are satisfied, the issuer may opt for rights issue of IDRs by filing a copy of the offer document prepared in accordance with the home country requirements along with an addendum containing disclosures as specified in **Part C** of **Schedule VIII** with the Board for record purposes, before filing the same with the stock exchanges.

CHAPTER IX

INITIAL PUBLIC OFFER BY SMALL AND MEDIUM ENTERPRISES

Reference date

227. Unless otherwise provided in this Chapter, an issuer making an initial public offer of specified securities shall satisfy the conditions of this Chapter as on the date of filing of the draft offer document with the SME exchange and also as on the date of registering the offer document with the Registrar of Companies.

PART I: ELIGIBILITY REQUIREMENTS

Entities not eligible to make an initial public offer

228. An issuer shall not be eligible to make an initial public offer:

a) if the issuer, any of its promoters, promoter group or directors or selling shareholders are debarred from accessing the capital market by the Board;

b) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board;

c) if the issuer or any of its promoters or directors is a willful defaulter.

d) if any of its promoters or directors is a fugitive economic offender.

Explanation: The restrictions under clauses (a) and (b) shall not apply to the persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft offer document with the SME Exchange.

Eligibility requirements for an initial public offer

229. (1) An issuer shall be eligible to make an initial public offer only if its post-issue paid-up capital is less than or equal to ten crore rupees.

(2) An issuer, whose post issue face value capital is more than ten crore rupees and upto twenty five crore rupees, may also issue specified securities in accordance with provisions of this Chapter.

(3) An issuer may make an initial public offer, if it satisfies track record and/or other eligibility conditions of the SME Exchange(s) on which the specified securities are proposed to be listed.

Provided that In case of an issuer which had been a partnership firm or a limited liability partnership, the track record of operating profit of the partnership firm or the limited liability partnership shall be considered only if the financial statements of the partnership business for the period during which the issuer was a partnership firm or a limited liability partnership, conform to and are revised in the format prescribed for companies under the Companies Act, 2013 and also comply with the following:

a) adequate disclosures are made in the financial statements as required to be made by the issuer as per **Schedule** III of the Companies Act,2013;

b) the financial statements are duly certified by auditors, who have subjected themselves to the peer review process of the Institute of Chartered Accountants of India (ICAI) and hold a valid certificate issued by the Peer Review Board' of the ICAI, stating that: (i) the accounts and the disclosures made are in accordance with the provisions of **Schedule** III of the Companies Act, 2013; (ii) the accounting standards prescribed under the Companies Act, 2013 have been followed; (iii) the financial statements present a true and fair view of the firm's accounts;

Provided further that in case of an issuer formed out of merger or a division of an existing company, the track record of the resulting issuer shall be considered only if the requirements regarding financial statements as specified above in the first proviso are complied with.

General conditions

230. (1) An issuer making an initial public offer shall ensure that:

a) it has made an application to one or more SME exchanges for listing of its specified securities on such SME exchange(s) and has chosen one of them as the designated stock exchange, in terms of Schedule XIX:

b) it has entered into an agreement with a depository for dematerialisation of its specified securities already issued and proposed to be issued;

c) all its existing partly paid-up equity shares have either been fully paid-up or forfeited;

d) all specified securities held by the promoters are in the dematerialized form;

e) it has made firm arrangements of finance through verifiable means towards seventy five per cent. of the stated means of finance for the project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public offer or through existing identifiable internal accruals.

Explanation: "project" means the object for which monies are proposed to be raised to cover the objects of the issue

(2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document shall not exceed twenty five per cent. of the amount being raised by the issuer.

PART II: ISSUE OF CONVERTIBLE DEBT INSTRUMENTS AND WARRANTS

231. An issuer shall be eligible to make an initial public offer of convertible debt instruments even without making a prior public issue of its equity shares and listing thereof.

Provided that an issuer shall not be eligible if it is in default of payment of interest or repayment of principal amount in respect of debt instruments issued by it to the public, if any, for a period of more than six months.

Additional requirements for issue of convertible debt instruments

232. (1) In addition to other requirements laid down in these regulations, an issuer making an initial public offer of convertible debt instruments shall also comply with the following conditions:

a) it has obtained credit rating from at least one credit rating agency;

b) it has appointed at least one debenture trustees in accordance with the provisions of the Companies Act, 2013 and the Securities and Exchange Board of India (Debenture Trustees) Regulations,1993;

c) it shall create a debenture redemption reserve in accordance with the provisions of the Companies Act, 2013 and the rules made there under;

d) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:

i) such assets are sufficient to discharge the principal amount at all times;

ii) such assets are free from any encumbrance;

iii) where security is already created on such assets in favour of any existing lender or security trustee or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such lender or security trustee or lessor for a second or pari passu charge has been obtained and submitted to the debenture trustee before the opening of the issue;

iv) the security or asset cover shall be arrived at after reduction of the liabilities having a first or prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

(2) The issuer shall redeem the convertible debt instruments as stipulated in the offer document.

Conversion of optionally convertible debt instruments into equity share capital

233. (1) The issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any listed convertible debt instruments issued by a issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares:

Provided that where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the option to convert the instruments into equity share capital at a price determined in the general meeting of the Shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

(4) The provision of sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

Issue of convertible debt instruments for financing

234. An issuer shall not issue convertible debt instruments for financing or for providing loans to or for acquiring shares of any person who is part of the promoter group or group companies;

Provided that an issuer shall be eligible to issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Issue of warrants

235. An issuer shall be eligible to issue warrants in an initial public offer subject to the following:

a) the tenure of such warrants shall not exceed eighteen months from their date of allotment in the initial public offer;

b) A specified security may have one or more warrants attached to it;

c) the price or formula for determination of exercise price of the warrants shall be determined upfront and disclosed in the offer document and at least twenty-five per cent. of the consideration amount based on the exercise price shall also be received upfront;

Provided that in case the exercise price of warrants is based on a formula, twenty-five per cent consideration amount based on the cap price of the price band determined for the linked equity shares or convertible securities shall be received upfront.;

d) in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within three months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

PART III: PROMOTERS' CONTRIBUTION

Minimum promoters' contribution

236. (1) The promoters of the issuer shall hold at least twenty per cent. of the post-issue capital:

Provided that in case the post-issue shareholding of the promoters is less than twenty per cent., alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India may contribute to meet the shortfall in minimum contribution as specified for the promoters, subject to a maximum of ten per cent. of the post-issue capital without being identified as promoter(s);

Provided further that the requirement of minimum promoters' contribution shall not apply in case an issuer does not have any identifiable promoter.

(2) The minimum promoters' contribution shall be as follows:

a) the promoters shall contribute twenty per cent. as stipulated sub-regulation (1), as the case may be, either by way of equity shares or by way of subscription to the convertible securities:

Provided that if the price of the equity shares allotted pursuant to conversion is not pre-determined and not disclosed in the offer document, the promoters shall contribute only by way of subscription to the convertible securities being issued in the public offer and shall undertake in writing to subscribe to the equity shares pursuant to conversion of such securities.

b) in case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre-determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities.

c) subject to the provisions of clause (a) and (b) above, in case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters shall bring in a contribution of at least twenty per cent. of the project cost in the form of equity shares, subject to contributing at least twenty per cent. of the issue size from its own funds in the form of equity shares:

Provided that if the project is to be implemented in stages, the promoters' contribution shall be with respect to total equity participation till the respective stage vis-à-vis the debt raised or proposed to be raised through the public coffer.

d) The promoters shall satisfy the requirements of this regulation at least one day prior to the date of opening of the issue.

e) In case the promoters have to subscribe to equity shares or convertible securities towards minimum promoters' contribution, the amount of promoters' contribution shall be kept in an escrow account with a scheduled commercial bank, which shall be released to the issuer along with the release of the issue proceeds:

Provided that where the promoters' contribution has already been brought in and utilised, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document;

Explanation: For the purpose of this regulation:

(I) Promoters' contribution shall be computed on the basis of the post-issue expanded capital:

a) assuming full proposed conversion of convertible securities into equity shares;

b) assuming exercise of all vested options, where any employee stock options are outstanding at the time of initial public offer.

(II) For computation of "weighted average price":

a) “weights” means the number of equity shares arising out of conversion of such specified securities into equity shares at various stages;

b) “price” means the price of equity shares on conversion arrived at after taking into account predetermined conversion price at various stages.

Securities ineligible for minimum promoters’ contribution

237. (1) For the computation of minimum promoters’ contribution, the following specified securities shall not be eligible:

a) specified securities acquired during the preceding three years, if they are:

i acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or

ii resulting from a bonus issue by utilisation of revaluation reserves or un realised profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters’ contribution;

b) specified securities acquired by the promoters and alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India, during the preceding one year at a price lower than the price at which specified securities are being offered to the public in the initial public offer:

Provided that nothing contained in this clause shall apply:

i. if the promoters and alternative investment funds as applicable, pay to the issuer the difference between the price at which the specified securities are offered in the initial public offer and the price at which the specified securities had been acquired;

ii. if such specified securities are acquired in terms of the scheme under 391 to 394 of the Companies Act, 1956 or sections 230 to 234 of the Companies Act, 2013, as approved by a High Court or a tribunal, as applicable, by the promoters in lieu of business and invested capital that had been in existence for a period of more than one year prior to such approval;

iii. to an initial public offer by a government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in the infrastructure sector;

c) specified securities allotted to the promoters and alternative investment funds during the preceding one year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms or limited liability partnerships, where the partners of the erstwhile partnership firms or limited liability partnerships are the promoters of the issuer and there is no change in the management:

Provided that specified securities, allotted to the promoters against the capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible;

d) specified securities pledged with any creditor.

(2) Specified securities referred to in clauses (a) and (c) of sub-regulation (1) shall be eligible for the computation of promoters' contribution, if such securities are acquired pursuant to a scheme which has been approved under the Companies Act, 2013 or any previous company law.

PART IV: LOCK-IN AND RESTRICTIONS ON TRANSFERRABILITY

Lock-in of specified securities held by the promoters

238. The specified securities held by the promoters shall not be transferable (hereinafter referred to as 'lock-in') for the periods as stipulated here under:

a) minimum promoters' contribution including contribution made by alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India, as applicable, shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the initial public offer, whichever is later;

b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year from the date of allotment in the initial public offer

Explanation: For the purposes of this clause, the expression "date of commencement of commercial production" means the last date of the month in which commercial production of the project in respect of which the funds raised are proposed to be utilised as stated in the offer document, is expected to commence.

Lock-in of specified securities held by persons other than the promoters

239. The entire pre-issue capital held by persons other than the promoters shall be locked-in for a period of one year from the date of allotment in the initial public offer:

Provided that nothing contained in this regulation shall apply to:

a) equity shares allotted to employees, whether currently an employee or not, under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme in accordance with **Part A** of **Schedule VI**;

b) equity shares held by an employee stock option trust or transferred to the employees by an employee stock option trust pursuant to exercise of options by the employees, whether currently employees or not, in accordance with the employee stock option plan or employee stock purchase scheme.

Provided that the equity shares allotted to the employees shall be subject to the provisions of lock-in as specified under the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014.

c) equity shares held by a venture capital fund or alternative investment fund of category I or Category II or a foreign venture capital investor:

Provided that such equity shares shall be locked in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

Explanation: For the purpose of clause (c), in case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period and convertible securities shall be deemed to be fully paid-up, if the entire consideration payable thereon has been paid and no further consideration is payable at the time of their conversion.

Lock-in of specified securities lent to stabilising agent under the green shoe option

240. The lock-in provisions shall not apply with respect to the specified securities lent to stabilising agent for the purpose of green shoe option, during the period starting from the date of lending of such specified securities and ending on the date on which they are returned to the lender in terms of sub-regulation (5) or (6) of regulation279:

Provided that the specified securities shall be locked-in for the remaining period from the date on which they are returned to the lender.

Inscription or recording of non-transferability

241. The certificates of specified securities which are subject to lock-in shall contain the inscription "non- transferable" and specify the lock-in period and in case such specified securities are dematerialised, the issuer shall ensure that the lock-in is recorded by the depository.

Pledge of locked-in specified securities

242. Specified securities held by the promoters and locked-in may be pledged as a collateral security for a loan granted by a scheduled commercial bank or a public financial institution or a systemically important non-banking finance company or a housing finance company, subject to the following:

a) if the specified securities are locked-in in terms of clause (a) of regulation 238, the loan has been granted to the issuer company or its subsidiary(ies) for the purpose of financing one or more of the objects of the issue and pledge of specified securities is one of the terms of sanction of the loan;

b) if the specified securities are locked-in in terms of clause (b) of regulation 238 and the pledge of specified securities is one of the terms of sanction of the loan.

Provided that such lock-in shall continue pursuant to the invocation of the pledge and such transferee shall not be eligible to transfer the specified securities till the lock-in period stipulated in these regulations has expired.

Transferability of locked-in specified securities

243. Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of shares and Takeovers) Regulations, 2011, the specified securities held by the promoters and locked-in as per regulation 238 may be transferred to another promoter or any person of the promoter group or a new promoter or a person in control of the issuer and the specified securities held by persons other than the promoters and locked-in as per regulation 239 may be transferred to any other person (including promoter or promoter group) holding the specified securities which are locked-in along with the securities proposed to be transferred:

Provided that the lock-in on such specified securities shall continue for the remaining period with the transferee and such transferee shall not be eligible to transfer them till the lock-in period stipulated in these regulations has expired.

PART V: APPOINTMENT OF LEAD MANAGERS, OTHER INTERMEDIARIES AND COMPLIANCE OFFICER

244. (1) The issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue.

(2) Where the issue is managed by more than one lead manager, the rights, obligations and responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each lead manager shall be predetermined and disclosed in the draft offer document and the offer document as specified in **Schedule I.**

(3) At least one lead manager to the issue shall not be an associate (as defined under the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992) of the issuer and if any of the lead manager is an associate of the issuer, it shall disclose itself as an associate of the issuer and its role shall be limited to marketing of the issue.

(4) The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with the Board after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.

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

Provided that such agreements may include such other clauses as the issuer and the intermediary may deem fit without diminishing or limiting in any way the liabilities and obligations of the lead manager(s), other intermediaries and the issuer under the Act, the Companies Act, 2013 or the Companies Act, 1956 (to the extent applicable), the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and the rules and regulations made thereunder or any statutory modification or statutory enactment thereof:

Provided further that in case of ASBA process, the issuer shall take cognisance of the deemed agreement of the issuer with self-certified syndicate banks.

(6) The issuer shall, in case of an issue made through the book building process, appoint syndicate member(s) and in the case of any other issue, appoint bankers to issue, at centres specified in **Schedule XII**.

(7) The issuer shall appoint a registrar to the issue, registered with the Board, which has connectivity with all the depositories:

Provided that if issuer itself is a registrar, it shall not appoint itself as registrar to the issue;

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

(8) The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

PART VI: DISCLOSURES IN AND FILING OF OFFER DOCUMENTS

Disclosures in the draft offer document and offer document

245. (1) The offer document shall contain all material disclosures which are true and adequate so as to enable the applicants to take an informed investment decision.

(2) Without prejudice to the generality of sub-regulation (1), the offer document shall contain:

a) disclosures specified in the Companies Act, 2013; and

b) disclosures specified in **Part A** of **Schedule VI**.

(3) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer document.

(4) The lead manager(s) shall call upon the issuer, its promoters and its directors or in case of an offer for sale, also the selling shareholders, to fulfil their obligations as disclosed by them in the draft offer document or offer document, as the case may be, and as required in terms of these regulations.

(5) The lead manager(s) shall ensure that the information contained in the offer document and the particulars as per audited financial statements in the offer document are not more than six months old from the issue opening date.

Filing of the offer document

246. (1) The issuer shall file a copy of the offer document with the Board through the lead manager(s), immediately upon registration of the offer document with the Registrar of Companies:

(2) The Board shall not issue any observation on the offer document.

(3) The lead manager(s) shall submit a due-diligence certificate as per **Form A** of **Schedule V** including additional confirmations as provided in **Form G of Schedule V** along with the offer document to the Board.

(4) The offer document shall be displayed from the date of filing in terms of sub-regulation (1) on the websites of the Board, the lead manager(s) and the SME exchange(s).

(5) The draft offer document and the offer documents shall also be furnished to the Board in a soft copy.

Offer document to be made available to public

247. (1) The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, Board and the SME exchange(s).

(2) The lead manager(s) and the SME exchange(s) shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

PART VII - PRICING

Face value of equity shares

248. The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, advertisements and application forms, along with the price band or the issue price in identical font size.

Pricing

249. (1) The issuer may determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book building process, as the case maybe.

(2) The issuer shall undertake the book building process in the manner specified in **Schedule XIII**.

Price and price band

250. (1) The issuer may mention a price or a price band in the offer document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

(2) The cap on the price band, and the coupon rate in case of convertible debt instruments shall be less than or equal to one hundred and twenty percent of the floor price.

(3) The floor price or the final price shall not be less than the face value of the specified securities.

(4) Where the issuer opts not to make the disclosure of the floor price or price band in the red herring prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue in the newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the format prescribed under Part A of **Schedule** X.

(5) The announcement referred to in sub-regulation (4) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" of the offer document.

(6) The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the SME exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the SME exchange(s).

Differential pricing

251. (1) The issuer may offer its specified securities at different prices, subject to the following:

a) retail individual investors or retail individual shareholders [or employees entitled for reservation made under regulation 254 may be offered specified securities at a price not lower than by more than ten per cent. of the price at which net offer is made to other categories of applicants, excluding anchor investors.

b) the differential pricing and the price at which net offer is proposed to be made to other categories of applicants shall be within the range such that the minimum application lot size shall remain uniform for all the applicants.

c) In case of a book built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants.

(2) Discount, if any, shall be expressed in rupee terms in the offer document.

PART VIII: ISSUANCE CONDITIONS AND PROCEDURE

Minimum offer to public

252. The minimum offer to the public shall be as per the provisions of clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules,1957.

Allocation in the net offer

253. (1) The allocation in the net offer category shall be as follows:

a) Not less than thirty five percent .to retail individual investors;

b) Not less than fifteen per cent. to non-institutional investors;

c) Not more than fifty per cent. To qualified institutional buyers, five per cent. of which shall be allocated to mutual funds:

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in any other category:

Provided further that in addition to five per cent. allocation available in terms of clause (c), mutual funds shall be eligible for allocation under the balance available for qualified institutional buyers.

"**Explanation:** If the retail individual investor category is entitled to more than the allocated portion on proportionate basis, the retail individual investors shall be allocated that higher percentage."

(2) In an issue made other than through the book building process, the allocation in the net offer category shall be made as follows:

a) minimum fifty per cent. to retail individual investors; and

b) remaining to:

i. individual applicants other than retail individual investors; and

ii. other investors including corporate bodies or institutions, irrespective of the number of specified securities applied for;

Provided that the unsubscribed portion in either of the categories specified in clauses (a) or (b) may be allocated to applicants in the other category.

Explanation - For the purpose of sub-regulation (2), if the retail individual investor category is entitled to more than fifty per cent. of the issue size on a proportionate basis, the retail individual investors shall be allocated that higher percentage.

Reservation on a competitive basis

254. (1) The issuer may make reservations on a competitive basis out of the issue size excluding promoters' contribution in favour of the following categories of persons:

a) employees;

b) shareholders (other than promoters and promoter group) of listed subsidiaries or listed promoter companies

Provided that the issuer shall not make any reservation for the lead manager(s), registrar, syndicate member(s), their promoters, directors and employees and for the group or associate companies (as defined under the Companies Act, 2013) of the lead manager(s), registrar, and syndicate member(s) and their promoters, directors and employees.

(2) The reservations on a competitive basis shall be subject to following conditions:

a) The aggregate of reservations for employees shall not exceed five per cent. of the post-issue capital of the issuer and the value of allotment to any employee shall not exceed two lakhs rupees:

Provided that in the event of under-subscription in the employee reservation portion, the unsubscribed portion may be allotted on a proportionate basis, for a value in excess of two lakhs rupees, subject to the total a allotment to an employee not exceeding five lakhs rupees.

b) Reservation for shareholders shall not exceed ten percent of the issue size;

c) no further application for subscription in the net offer can be made by persons (except an employee and retail individual shareholder) in favour of whom reservation on a competitive basis is made;

d) any unsubscribed portion in any reserved category may be added to any other reserved category(ies) and the unsubscribed portion, if any, after such inter-se adjustments among the reserved categories shall be added to the net offer category;

e) In case of under-subscription in the net offer category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net public coffer.

(3) An applicant in any reserved category may make an application for any number of specified securities but not exceeding the reserved portion for that category.

Abridged prospectus

255. (1) The abridged prospectus shall contain the disclosures as specified in **Part E** of **Schedule VIII** and shall not contain any matter extraneous to the contents of the offer document.

(2) Every application form distributed by the issuer or any other person in relation to an issue shall be accompanied by a copy of the abridged prospectus

ASBA

256. The issuer shall accept bids using only the ASBA facility in the manner specified by the Board.

Availability of issue material

257. The lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stock brokers, underwriters, bankers to the issue, investors' associations and self certified syndicate banks before the opening of the issue.

Prohibition on payment of incentives

258. Any person connected with the distribution of the issue, shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the initial public offer, except for fees or commission for services rendered in relation to the issue.

Security deposit

259. (1) The issuer shall, before the opening of subscription list, deposit with the designated stock exchange, an amount calculated at the rate of one per cent. of the issue size available for subscription to the public in the manner specified by Board and/or stock exchange(s).

(2) The amount specified in sub-regulation (1) shall be refundable or forfeitable in the manner specified by the Board.

Underwriting

260. (1) The initial public offer shall be underwritten for hundred per cent of the offer and shall not be restricted upto the minimum subscription level.

(2) The lead manager(s) shall underwrite at least fifteen per cent. of the issue size on their own account(s).

(3) The issuer, in consultation with lead manager(s), may appoint underwriters in accordance with Securities and Exchange Board of India (Underwriters) Regulations, 1993 and the lead manager(s) may enter into an agreement with the nominated investors indicating therein the number of specified securities which they agree to subscribe at the issue price in case of under- subscription.

(4) The lead manager(s) shall file an undertaking to the Board that the issue has been hundred per cent. underwritten along with the list of underwriters, nominated investors and sub-underwriters indicating the extent of underwriting or subscription commitment made by each of them, one day before the opening of issue.

(5) If any of the underwriters fail to fulfill their underwriting obligations or the nominated investors fail to subscribe to the unsubscribed portion, the lead manager(s) shall fulfill the underwriting obligations.

(6) The underwriters/ sub-underwriters, other than the lead manager(s) and the nominated investors, who have entered into an agreement for subscribing to the issue in case of under- subscription, shall not subscribe to the issue made under this chapter in any manner except for fulfilling their obligations under their respective agreements with the lead manager(s) in this regard.

(7) All underwriting and subscription arrangements made by the lead manager(s) shall be disclosed in the offer document.

Market making

261. (1) The lead manager(s) shall ensure compulsory market making through the stock brokers of the SME exchange(s) appointed by the issuer, in the manner specified by the Board for a minimum period of three years from the date of listing of the specified securities or from the date of migration from the Main Board in terms of regulation 276.

(2) The market maker or issuer, in consultation with the lead manager(s) may enter into agreements with the nominated investors for receiving or delivering the specified securities in market making, subject to the prior approval of the SME exchange.

(3) The issuer shall disclose the details of the market making arrangement in the offer document.

(4) The specified securities being bought or sold in the process of market making may be transferred to or from the nominated investors with whom the lead manager(s) and the issuer have entered into an agreement for market making:

Provided that the inventory of the market maker, as on the date of allotment of the specified securities, shall be at least five per cent of the specified securities proposed to be listed on SME exchange.

(5) The market maker shall buy the entire shareholding of a shareholder of the issuer in one lot, where the value of such shareholding is less than the minimum contract size allowed for trading on the SMEexchange:

Provided that market maker shall not sell in lots less than the minimum contract size allowed for trading on the SME exchange.

(6) The market maker shall not buy the shares from the promoters or persons belonging to the promoter group of the issuer or any person who has acquired shares from such promoter or person belonging to the promoter group during the compulsory market making period.

(7) The promoters' holding shall not be eligible for offering to the market maker during the compulsory market making period:

Provided that the promoters' holding which is not locked-in as per these regulations can be traded with prior permission of the SME exchange, in the manner specified by the Board.

(8) The lead manager(s) may be represented on the board of directors of the issuer subject to the agreement between the issuer and the lead manager(s) who have the responsibility of market making.

Monitoring agency

262. (1) If the issue size, excluding the size of offer for sale by selling shareholders, exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by one of the scheduled commercial banks named in the offer document as bankers of the issuer:

Provided that nothing contained in this clause shall apply to an issue of specified securities made by a bank or public financial institution or an insurance company.

(2) The monitoring agency shall submit its report to the issuer in the format specified in **Schedule XI** on a quarterly basis, till at least ninety five per cent. of the proceeds of the issue, excluding the proceeds raised for general corporate purposes, have been utilised.

(3) The board of directors and the management of the issuer shall provide their comments on the findings of the monitoring agency as specified in **Schedule XI**.

(4) The issuer shall, within forty five days from the end of each quarter, publicly disseminate the report of the monitoring agency by uploading the same on its website as well as submitting the same to the stock exchange(s) on which its equity shares are listed.

Public communications, publicity materials, advertisements and research reports

263. All public communications, publicity materials, advertisements and research reports shall comply with provisions of **Schedule IX**.

Issue-related advertisements

264. (1) Subject to the provisions of the Companies Act, 2013, the issuer shall, after registering the prospectus with the Registrar of Companies, make a pre-issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.

(2) The pre-issue advertisement shall be in the format and shall contain the disclosures specified in **Part A** of **Schedule X**.

Provided that the disclosures in relation to price band or floor price and financial ratios contained therein shall only be applicable where the issuer opts to announce the price band or floor price along with the pre-issue advertisement pursuant to sub-regulation (4) of regulation 250.

(3) The issuer may issue advertisements for issue opening and issue closing advertisements, which shall be in the formats specified in **Parts B and C** of **Schedule X.**

(4) During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed or indicating investors' response to the issue.

(5) An announcement regarding closure of the issue shall be made only after the lead manager(s) is satisfied that at least ninety per cent. of the offer has been subscribed and a certificate has been obtained to that effect from the registrar to the issue:

Provided that such an announcement shall not be made before the date on which the issue is to be closed except for issue closing advertisement made in the format prescribed in these regulations.

Opening of the issue

265. The issue shall be opened after at least three working days from the date of registering the offer document with the Registrar of Companies.

Period of subscription

266. (1) Except as otherwise provided in these regulations, a public issue shall be kept open for at least three working days and not more than ten working days.

(2) In case of a revision in the price band, the issuer shall extend the bidding (issue) period disclosed in the red herring prospectus, for a minimum period of three working days, subject to the provisions of sub-regulation (1).

(3) In case of force majeure, banking strike or similar circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding (issue) period disclosed in the red herring prospectus (in case of a book built issue) or the issue period disclosed in the prospectus (in case of a fixed price issue), for a minimum period of three working days, subject to the provisions of sub-regulation (1).

Application and minimum application value

267. (1) A person shall not make an application in the net offer category for a number of specified securities that exceeds the total number of specified securities offered to the public.

Provided that the maximum application by non-institutional investors shall not exceed total number of specified securities offered in the issue less total number of specified securities offered in the issue to qualified institutional buyers.

(2) The minimum application size shall be one lakh rupees per application.

(3) The issuer shall invite applications in multiples of the minimum application amount, an illustration whereof is given in **Part B of Schedule XIV**.

(4) The minimum sum payable on application per specified security shall at least be twenty five per cent. of the issue price:

Provided that in case of an offer for sale, the full issue price for each specified security shall be payable on application.

Explanation: For the purpose of this regulation, "minimum application value" shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.

Allotment procedure and basis of allotment

268. (1) The issuer shall not make an allotment pursuant to a public issue if the number of allottees in an initial public offer is less than fifty.

(2) The issuer shall not make any allotment in excess of the specified securities offered through the offer document except in case of oversubscription for the purpose of rounding off to make allotment, in consultation with the designated stock exchange.

Provided that in case of oversubscription, an allotment of not more than ten per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

(3) The allotment of specified securities to applicants other than retail individual investors and anchor investors shall be on proportionate basis within the specified investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed in the offer document:

Provided that the value of specified securities allotted to any person, except in case of employees, in pursuance of reservation made under clause (a) of sub-regulation (1) or clause (a) of sub-regulation (2) of regulation 254, shall not exceed two lakhs rupees.

(4) The authorised employees of the stock exchange, along with the lead manager(s) and registrars to the issue, shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the allotment procedure as specified in **Part A of Schedule XIV**.

Allotment, refund and payment of interest

269. (1) The registrars to the issue, in consultation with the issuer and lead manager(s) shall ensure that the specified securities are allotted and/or application monies are refunded or unblocked within such time as may be specified by the Board.

(2) The lead manager(s) shall ensure that the allotment, credit of dematerialised securities, refunding or unlocking of application monies, as may be applicable, are done electronically.

(3) Where the specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated in sub-regulation (1) above, the issuer shall undertake to pay interest at the rate of fifteen per cent. per annum and within such time as disclosed in the offer document and the lead manager(s) shall ensure the same.

Post-issue advertisements

270. (1) The lead manager(s) shall ensure that advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of dispatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the Registrar, date of credit of specified securities and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated.

(2) Details specified in sub regulation (1) shall also be placed on the website of the stock exchanges.

Post-issue responsibilities of the lead manager(s)

271. (1) The responsibility of the lead manager(s) shall continue until completion of the issue process and for any issue related matter thereafter.

(2) The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.

(3) The lead manager(s) shall be responsible for and co-ordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from syndicate member(s) or collecting bank branches and or self-certified syndicate banks, processing of the applications including application form for ASBA and other matters till the

basis of allotment is finalised, credit of the specified securities to the demat accounts of the allottees and unblocking of ASBA accounts/ despatch of refund orders are completed and securities are listed, as applicable.

(4) Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to the Board.

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

(6) In the case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information in respect of underwriters who have failed to meet their underwriting devolvement to the Board in the format specified in **Schedule XVIII**.

Release of subscription money

272. (1) The lead manager(s) shall confirm to the bankers to the issue by way of copies of listing and trading approvals that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue.

(2) In case the issuer fails to obtain listing or trading permission from the stock exchanges where the specified securities were to be listed, it shall refund through verifiable means the entire monies received within seven days of receipt of intimation from stock exchanges rejecting the application for listing of specified securities, and if any such money is not repaid within eight days after the issuer becomes liable to repay it the issuer and every director of the company who is an officer in default shall, on and from the expiry of the eighth day, be jointly and severally liable to repay that money with interest at the rate of fifteen per cent per annum.

(3) The lead manager(s) shall ensure that the monies received in respect of the issue are released to the issuer in compliance with the provisions of the Section 40 (3) of the Companies Act, 2013, as applicable.

Post-issue reports

273. The lead manager(s) shall submit a final post-issue report as specified in **Part A** of **Schedule XVII**, along with a due diligence certificate as per the format specified in **Form F** of **Schedule V,** within seven days of the date of finalization of basis of allotment or within seven days of refund of money in case of failure of issue.

Reporting of transactions of the promoters and promoter group

274. The issuer shall ensure that all transactions in securities by the promoters and promoter group between the date of filing of the draft offer document or offer document, as the case may be, and the date of closure of the issue shall be reported to the stock exchanges, within twenty four hours of such transactions.

Listing

275. Where any listed issuer issues specified securities in accordance with provisions of this Chapter, it shall migrate the specified securities already listed on any recognised stock exchange(s) to the SMEexchange.

Migration to the SME exchange

276. A listed issuer whose post-issue face value capital is less than twenty five crore rupees may migrate its specified securities to SME exchange if its shareholders approve such migration by passing a special resolution through postal ballot to this effect and if such issuer fulfils the eligibility criteria for listing laid down by the SMEexchange:

Provided that the special resolution shall be acted upon if and only if the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

Migration to the main board

277. An issuer, whose specified securities are listed on a SME Exchange and whose post-issue face value capital is more than ten crore rupees and up to twenty five crore rupees, may migrate its specified securities to the main board of the stock exchanges if its shareholders approve such a migration by passing a special resolution through postal ballot to this effect and if such issuer fulfils the eligibility criteria for listing laid down by the Main Board:

Provided that the special resolution shall be acted upon if and only if the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

PART IX: MISCELLANEOUS

Restriction on further capital issues

278. An issuer shall not make any further issue of specified securities in any manner whether by way of public issue, rights issue, preferential issue, qualified institutions placement, issue of bonus shares or otherwise, except pursuant to an employee stock option scheme, during the period between the date of filing the draft offer document and the listing of the specified securities offered through the offer document or refund of application monies unless full disclosures regarding the total number of specified securities or amount proposed to be raised from such further issue are made in such draft offer document or offer document, as the case maybe.

Price stabilisation through green shoe option

279. (1) The issuer may provide green shoe option for stabilizing the post listing price of its specified securities, subject to the following:

a) the issuer has been authorized, by a resolution passed in the general meeting of shareholders approving the public issue, to allot specified securities to the stabilising agent, if required, on the expiry of the stabilization period;

b) the issuer has appointed a lead manager(s) appointed by the issuer as a stabilising agent, who shall be responsible for the price stabilization process;

c) prior to filing the draft offer document, the issuer and the stabilizing agent have entered into an agreement, stating all the terms and conditions relating to the green shoe option including fees charged and expenses to be incurred by the stabilising agent for discharging its responsibilities;

d) prior to filing the offer document, the stabilizing agent has entered into an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them in accordance with clause (g) of this sub-regulation, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size (hereinafter referred to as the "over-allotment"), which shall not be in excess of fifteen percent.of the issue size;

e) subject to clause (d), the lead manager(s), in consultation with the stabilising agent, shall determine the amount of specified securities to be over-allotted in the public issue;

f) the draft offer document and offer document shall contain all material disclosures about the green shoe option specified in this regard in **Part A** of **Schedule VI**;

g) incase of an initial public offer pre-issue shareholders and promoters and in case of a furtherpublic offer pre-issue shareholders holding more than five per cent. specified securities and promoters,may lend specified securities to the extent of the proposed over-allotment;

h) the specified securities borrowed shall be in dematerialised form and allocation of these securities shall be made pro-rata to all successful applicants.

(2) For the purpose of stabilization of post-listing price of the specified securities, the stabilising agent shall determine the relevant aspects including the timing of buying such securities, quantity to be bought and the price at which such securities are to be bought from the market.

(3) The stabilisation process shall be available for a period not exceeding thirty days from the date on which trading permission is given by the stock exchanges in respect of the specified securities allotted in the public issue.

(4) The stabilizing agent shall open a special account, distinct from the issue account, with a bank for crediting the monies received from the applicants against the over-allotment and a special account with a depository participant for crediting specified securities to be bought from the market during the stabilisation period out of the monies credited in the special bank account.

(5) The specified securities bought from the market and credited in the special account with the depository participant shall be returned to the promoters or pre-issue shareholders immediately, in any case not later than two working days after the end of the stabilization period.

(6) On expiry of the stabilisation period, if the stabilizing agent has not been able to buy specified securities from the market to the extent of such securities over-allotted, the issuer shall allot specified securities at issue price in dematerialised form to the extent of the shortfall to the special account with the depository participant, within five days of the closure of the stabilization period and such specified securities shall be returned to the promoters or pre-issue shareholders by the stabilizing agent in lieu of the specified securities borrowed from them and the account with the depository participant shall be closed thereafter.

(7) The issuer shall make a listing application in respect of the further specified securities allotted under sub-regulation (6), to all the stock exchanges where the specified securities allotted in the public issue are listed and the provisions of Chapter VII shall not be applicable to such allotment.

(8) The stabilizing agent shall remit the monies with respect to the specified securities allotted under sub-regulation (6) to the issuer from the special bank account.

(9) Any monies left in the special bank account after remittance of monies to the issuer under sub-regulation (8) and deduction of expenses incurred by the stabilizing agent for the stabilisation process shall be transferred to the Investor Protection and Education Fund established by the Board and the special bank account shall be closed soon thereafter.

(10) The stabilising agent shall submit a report to the stock exchange on a daily basis during the stabilization period and a final report to the Board in the format specified in **Schedule XV**.

(11) The stabilizing agent shall maintain a register for a period of at least three years from the date of the end of the stabilization period and such register shall contain the following particulars:

a) The names of the promoters or pre-issue shareholders from whom the specified securities were borrowed and the number of specified securities borrowed from each of them;

b) The price, date and time in respect of each transaction effected in the course of the stabilization process; and

c) The details of allotment made by the issuer on expiry of the stabilisation process.

Alteration of rights of holders of specified securities

280. (1) The issuer shall not alter the terms (including the terms of issue) of specified securities which may adversely affect the interests of the holders of that specified securities, except with the consent in writing of the holders of not less than three-fourths of the specified securities of that class or with the sanction of a special resolution passed at a meeting of the holders of the specified securities of that class.

(2) Where the post-issue face value capital of an issuer listed on a SME exchange is likely to increase beyond twenty five crore rupees by virtue of any further issue of capital by the issuer by way of rights issue, preferential issue, bonus issue, etc. the issuer shall migrate its specified securities listed on a SME exchange to the Main Board and seek listing of the specified securities proposed to be issued on the Main Board subject to the fulfilment of the eligibility criteria for listing of specified securities laid down by the Main Board:

Provided that no further issue of capital by the issuer shall be made unless –

a) the shareholders of the issuer have approved the migration by passing a special resolution through postal ballot wherein the votes cast by shareholders other than promoters in favour of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal;

b) the issuer has obtained an in-principle approval from the Main Board for listing of its entire specified securities on it.

Further Issues

281. An issuer listed on a SME exchange making a further issue of capital by way of a rights issue, or further public offer or preferential issue or bonus issue etc. may do so by adhering to applicable requirements mentioned in these regulations.

CHAPTER X

INNOVATORS GROWTH PLATFORM

PART I: APPLICABILITY

282. (1) The provisions of this Chapter shall apply to issuers seeking listing of their specified securities pursuant to an initial public offer or for only trading on a stock exchange of their specified securities without making a public offer.

(2) The provisions of these regulations, in respect of the matters not specifically dealt or excluded under this Chapter, shall apply *mutatis mutandis* to any listing or trading of specified securities under this Chapter.

Provided that the following shall not apply:

a) sub-regulation (2) of regulation 7 on restrictions on the amount of general corporate purposes; and

b) sub-regulation (1) and (2) of regulation 6 on eligibility requirements

(3) The institutional trading platform shall be accessible only to institutional investors and non-institutional investors.

Eligibility

283. (1) An issuer which is intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition shall be eligible for listing on the innovators growth platform, provided that as on the date of filing of draft information document or draft offer document with the Board, as the case may be, twenty five per cent of the pre-issue capital of the Issuer Company for at least a period of two years, should have been held by:

I. Qualified Institutional Buyers;

II. Family trust with net-worth of more than five hundred crore rupees, as per the last audited financial statements;

III. Accredited Investors for the purpose of Innovators Growth Platform;

IV. The following regulated entities:

a) Category III Foreign Portfolio Investor;

b) An entity meeting all the following criteria:

I. It is a pooled investment fund with minimum assets under management of one hundred and fifty million USD;

II. It is registered with a financial sector regulator in the jurisdiction of which it is a resident;

III. It is resident of a country whose securities market regulator is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding (Appendix A Signatories) or a signatory to Bilateral Memorandum of Understanding with the Board;

IV. It is not resident in a country identified in the public statement of Financial Action Task Force as:

a) a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

b) a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

Explanation:

a) The following entities shall be eligible to be considered as accredited investors for the purpose of innovators growth platform:

(i) any individual with total gross income of fifty lakhs rupees annually and who has minimum liquid net worth of five crore rupees; or

(ii) any body corporate with net worth of twenty five crore rupees.

b) Not more than ten per cent of the pre-issue capital may be held by Accredited Investors.

c) For the purpose of accreditation: The persons /corporate bodies who wish to get accreditation for the purpose of innovators growth platform, shall approach the stock exchanges or depositories and follow the procedures prescribed by the Board and / or such stock exchange or depository for the purpose of accreditation as an Accredited Investor, from time to time.

(2) An issuer shall be eligible for listing on the institutional trading platform if none of the promoters or directors of the issuer company is a fugitive economic offender.

PART II: LISTING WITHOUT A PUBLIC ISSUE

Listing without a public issue

284. (1) An issuer seeking listing of its specified securities without making a public offer, shall file a draft information document along with the necessary documents with the Board in accordance with these regulations along with the fee as specified in **Schedule III** of these regulations.

(2) The draft information document shall contain disclosures as specified for the draft offer documents in these regulations as specified in **Part A** of **Schedule VI**.

(3) The regulations relating to the following as stated under the Chapter of Initial Public Offer on Main Board shall not be applicable:

a) allotment;

b) issue opening or closing;

c) advertisements;

d) underwriting;

e) sub-regulation (2) of regulation5;

f) pricing;

g) dispatch of issue material; and

h) other such provisions related to offer of specified securities to the public.

(4) The issuer shall obtain an in-principle approval from the stock exchanges on which it proposes to get its specified securities listed.

(5) The issuer shall list its specified securities on the recognised stock exchange(s within thirty days:

a) from the date of issuance of observations by the Board; or

b) from the expiry of the period stipulated in sub-regulation (4) of regulation 25, if the Board has not issued any such observations.

(6) The issuer which has received an in-principle approval from the stock exchange for listing of its specified securities, shall be deemed to have been waived by the Board under sub-rule (7) of rule 19 from the requirement of minimum offer to the public as per the provisions of clause (b) of sub-rule (2) of rule 19 of Securities Contracts (Regulation) Rules, 1957 for the limited purpose of listing on the innovators growth platform.

(7) Provisions relating to minimum public shareholding shall not be applicable.

(8) The draft and final information document shall be approved by the board of directors of the issuer and shall be signed by all directors, the Chief Executive Officer, i.e., the Managing Director or Manager within the meaning of the Companies Act, 2013 and the Chief Financial Officer, i.e., the Whole-time Finance Director or any other person heading the finance function and discharging that function.

(9) The signatories shall also certify that all disclosures made in the information document are true and correct.

(10) In case of mis-statement in the information document or any omission therein, any person who has authorized the issue of information document shall be liable in accordance with the provisions of the Act and regulations made thereunder.

Explanation: Under this Part, the phrases 'pre-issue' and 'post-issue', wherever they occur shall be construed as 'pre-listing' and 'post-listing', respectively.

PART III: LISTING PURSUANT TO AN INITIAL PUBLIC OFFER

Disclosures in draft offer document and offer document

285. (1) An issuer seeking to issue and list its specified securities shall file a draft offer document along with necessary documents with the Board in accordance with these regulations along with the fees as specified in **Schedule III** of these regulations.

(2) The draft offer document shall disclose the broad objects of the issue.

(3) The basis of issue price shall include disclosures, except projections, as deemed fit by the issuer in order to enable the investors to take informed decisions and the disclosures shall suitably contain the basis of valuation.

Minimum public shareholding norms and minimum offer size

285A. (1) The issuer shall be in compliance with minimum public shareholding requirements specified in the Securities Contracts (Regulation) Rules, 1957.

(2) The minimum offer size shall be ten crore rupees.

Minimum application size

286. The minimum application size shall be two lakh rupees and in multiples thereof.

Allocation and allotment

287. (1) The number of allottees in the initial public offer shall at least be fifty.

(2) The allotment to institutional investors as well as non-institutional investors shall be on a proportionate basis.

(3) Any under-subscription in the non-institutional investor category shall be available for subscription under the institutional investors' category.

PART IV: GENERAL CONDITIONS

Lock-in

288. (1) The entire pre-issue capital of the shareholders shall be locked-in for a period of six months from the date of allotment in case of listing pursuant to a public issue or date of listing in case of listing without a public issue:

Provided that nothing contained in this regulation shall apply to:

a) equity shares allotted to employees, whether currently an employee or not, under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme in accordance with Part A of **Schedule VI**;

b) equity shares held by an employee stock option trust or transferred to the employees by an employee stock option trust pursuant to exercise of options by the employees, whether currently employees or not, in accordance with the employee stock option plan or employee stock purchase scheme.

Provided that the equity shares allotted to the employees shall be subject to the provisions of lock-in as specified under the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014.

c) equity shares held by a venture capital fund or alternative investment fund of Category I or a foreign venture capital investor:

d) Provided that such equity shares shall be locked-in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

e) equity shares held by persons other than the promoters, continuously for a period of at least one year prior to the date of listing in case of listing without a public issue:

Explanation: For the purpose of clause (c) and (d), in case such equity shares have resulted pursuant to conversion of fully paid-up compulsorily convertible securities, the holding period of such convertible securities as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period and the convertible securities shall be deemed to be fully paid-up, if the entire consideration payable thereon has been paid at the time of their conversion.

(2) The specified securities held by the promoters and locked-in may be pledged with any scheduled commercial bank or public financial institution or systemically important non-banking finance company as a collateral security for a loan granted by such bank or institution or systemically

important non-banking finance company if the pledge of specified securities is one of the terms of sanction of the loan.

(3) The specified securities that are locked-in may be transferable in accordance with regulation 288 of these regulations.

(4) All specified securities allotted on a discretionary basis shall be locked-in in accordance with the requirements for lock-in for the anchor investors on the main board of the stock exchange, as specified under Part A of **Schedule XIII**.

Trading lot

289. The minimum trading lot on the stock exchange shall be two lakh rupees and in multiples thereof.

Exit of issuers whose securities are trading without making a public offer

290. An issuer whose specified securities are traded on the innovators growth platform without making a public issue may exit from that platform, if

a) its shareholders approve such an exit by passing a special resolution through postal ballot where ninety per cent of the total votes and the majority of non-promoter votes have been cast in favor of such proposal; and

b) the recognised stock exchange where its shares are listed approves of such an exit.

Withdrawal of approval by the stock exchange

291. (1) The recognised stock exchange may delist the specified securities of an issuer listed without making a public issue upon non-compliance of the conditions of listing and in the manner as specified by the stock exchange.

(2) No issuer promoted by the promoters and directors of an entity delisted under sub-regulation (1), shall be permitted to list on the innovators growth platform for a period of five years from the date of such delisting:

Provided that the provisions of this regulation shall not apply to another issuer promoted by any of the independent directors of such a delisted issuer.

Migration to the main board

292. An issuer that has listed its specified securities on a recognised stock exchange may at its option migrate to the main board of that recognised stock exchange after expiry of three years from the date of listing subject to compliance with the eligibility requirements of the stock exchange.

CHAPTER XI

BONUS ISSUE

Conditions for a bonus issue

293. Subject to the provisions of the Companies Act, 2013 or any other applicable law, a listed issuer shall be eligible to issue bonus shares to its members if:

a) it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves etc.:

Provided that if there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;

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

c) it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;

d) any outstanding partly paid shares on the date of the allotment of the bonus shares, are made fully paid-up;

e) any of its promoters or directors is not a fugitive economic offender.

Restrictions on a bonus issue

294. (1) An issuer shall make a bonus issue of equity shares only if it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments if any, in proportion to the convertible part thereof.

(2) The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments, shall be issued to the holder of such convertible debt instruments or warrants at the time of conversion of such convertible debt instruments, optionally convertible instruments, warrants, as the case may be, on the same terms or same proportion at which the bonus shares were issued.

(3) A bonus issue shall be made only out of free reserves, securities premium account or capital redemption reserve account and built out of the genuine profits or securities premium collected in cash and reserves created by revaluation of fixed assets shall not be capitalised for this purpose.

(4) Without prejudice to the provisions of sub-regulation (3), bonus shares shall not be issued in lieu of dividends.

Completion of a bonus issue

295. (1) An issuer, announcing a bonus issue after approval by its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors:

Provided that where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

Explanation: For the purpose of a bonus issue to be considered as 'implemented' the date of commencement of trading shall be considered.

(2) A bonus issue, once announced, shall not be withdrawn.

CHAPTER XII

MISCELLANEOUS

Directions by the Board

296. Without prejudice to the power under sections 11, 11A, 11B, 11D, sub-section (3) of section 12, Chapter VIA and section 24 of the Act, the Board may either *suo motu* or on receipt of information or on completion or pendency of any inspection, inquiry or investigation, in the interests of investors or the securities market, issue such directions or orders as it deems fit including any or all of the following:

a) directing the persons concerned not to access the securities market for a specified period;

b) directing the person concerned to sell or divest the securities;

c) any other direction which Board may deem fit and proper in the circumstances of the case:

Provided that the Board shall, either before or after issuing such direction or order, give a reasonable opportunity of being heard to the person concerned:

Provided further that if any interim direction or order is required to be issued, the Board may give post-decisional hearing to the person concerned.

Liability for contravention of the Act, rules or the regulations

297. (1) The listed issuer or any other person thereof who contravenes any of the provisions of these regulations, shall, in addition to the liability for action in terms of the securities laws, be liable for the following actions by the respective stock exchange(s), in the manner specified by the Board:

a) imposition of fines;

b) suspension of trading;

c) freezing of promoter/promoter group holding of designated securities, as may be applicable in coordination with depositories;

d) any other action as may be specified by the Board from time to time.

(2) The manner of revocation of actions specified in clauses (b) and (c) of sub-regulation (1), shall be in the manner specified by the Board.

Failure to pay fine

298. If the listed issuer fails to pay any fine imposed upon it by the recognised stock exchange(s), within the period as specified from time to time, the stock exchange may initiate such other action in accordance with the bye-laws of such Stock Exchange after giving a notice in writing.

Power to remove difficulty

299. In order to remove any difficulties in the application or interpretation of these regulations, the Board may issue clarifications through guidance notes or circulars after recording reasons in writing.

Power to relax strict enforcement of the regulations

300. (1) The Board may, in the interest of investors or for the development of the securities market, relax the strict enforcement of any requirement of these regulations, if the Board is satisfied that:

a) the requirement is procedural in nature; or

b) any disclosure requirement is not relevant for a particular class of industry or issuer; or

c) the non-compliance was caused due to factors beyond the control of the issuer.

(2) For seeking relaxation under sub-regulation (1), an application, giving details and the grounds on which such relaxation has been sought, shall be filed with the Board.

(3) The application referred to under sub-regulation (2) shall be accompanied by a non-refundable fee of rupees one lakh payable by way of direct credit in the bank account through NEFT/ RTGS/ IMPS or any other mode allowed by RBI or by way of a demand draft in favour of the Board payable in Mumbai.

Repeal and Savings

301. (1) On and from the commencement of these regulations, the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements), Regulations 2009 shall stand rescinded.

(2) Notwithstanding such rescission:

a) anything done or any action taken or purported to have been done or taken including observation made in respect of any draft offer document, any enquiry or investigation commenced or show cause notice issued in respect of the said Regulations shall be deemed to have been done or taken under the corresponding provisions of these regulations.

b) any offer document, whether draft or otherwise, filed or application made to the Board under the said Regulations and pending before it shall be deemed to have been filed or made under the corresponding provisions of these regulations.

CHAPTER 2

SEBI (LODR) REGULATIONS, 2015

CHAPTER I

PRELIMINARY

Short title and commencement

1. (1) These regulations may be called the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

(2) They shall come into force on the ninetieth day from the date of their publication in the Official Gazette:

Provided that the provisions of sub-regulation (4) of regulation 23 and regulation 31A shall come into force on the date of notification of these regulations.

Definitions

2. (1) In these regulations, unless the context otherwise requires:—

(a) “Act” means the Securities and Exchange Board of India Act, 1992 (15 of 1992);

(b) “associate” shall mean any entity which is an associate under sub-section (6) of section 2 of the Companies Act, 2013 or under the applicable accounting standards:

Provided that this definition shall not be applicable for the units issued by mutual fund which are listed on a recognised stock exchange(s) for which the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 shall be applicable;

(c) "Board" means the Securities and Exchange Board of India established under section 3 of the Act;

(d) “board of directors” or “board of trustees” shall mean the board of directors or board of trustees, whichever applicable, of the listed entity;

(e) “chief executive officer” or “managing director” or “manager” shall mean the person so appointed in terms of the Companies Act, 2013;

(f) “chief financial officer” or “whole time finance director” or “head of finance”, by whatever name called, shall mean the person heading and discharging the finance function of the listed entity as disclosed by it to the recognised stock exchange(s) in its filing under these regulations;

(g) “committee” shall mean committee of board of directors or any other committee so constituted;

(h) “designated securities” means specified securities, non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non-cumulative preference shares, Indian depository receipts, securitised debt instruments, security receipts, units issued by mutual funds and any other securities as may be specified by the Board ;

(i) “financial year” shall have the same meaning as assigned to it under sub-section (41) of section 2 of the Companies Act, 2013;

(ia) “fugitive economic offender” shall mean an individual who is declared a fugitive economic offender under section 12 of the Fugitive Economic Offenders Act, 2018 (17 of 2018);

(j) "global depository receipts” means global depository receipts as defined in subsection (44) of section 2 of the Companies Act, 2013;

(k) “half year” means the period of six months commencing on the first day of April or October of a financial year;

(l) “half yearly results” means the financial results prepared in accordance with these regulations in respect of a half year;

(m) "holding company" means a holding company as defined in sub-section (46) of section 2 of the Companies Act, 2013;

(n) ‘Indian depository receipts’ means Indian depository receipts as defined in sub section(48) of section 2 of the Companies Act, 2013;

(na) “Insolvency Code” means the Insolvency and Bankruptcy Code, 2016 [No. 31 of 2016]

(o) “key managerial personnel” means key managerial personnel as defined in subsection (51) of section 2 of the Companies Act, 2013;

(p) "listed entity" means an entity which has listed, on a recognised stock exchange(s), the designated securities issued by it or designated securities issued under schemes managed by it, in accordance with the listing agreement entered into between the entity and the recognised stock exchange(s);

(q) “listing agreement” shall mean an agreement that is entered into between a recognised stock exchange and an entity, on the application of that entity to the recognised stock exchange, undertaking to comply with conditions for listing of designated securities;

(r) “main board" means main board as defined in clause (a) of sub-regulation (1) of regulation 106N of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(s) “net worth” means net worth as defined in sub-section (57) of section 2 of the Companies Act, 2013;

(t) ‘non-convertible debt securities’ which is ‘debt securities’ as defined under regulation 2(1)(e) of the Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;

(u) ‘non-convertible redeemable preference shares’, ‘perpetual debt instrument’/'innovative perpetual debt instrument' and ‘perpetual noncumulative preference share’ shall have the same meaning as assigned to them in the Securities and Exchange Board of India (Issue and Listing of Non Convertible Redeemable Preference Shares) Regulations, 2013;

(v) "offer document" shall have the same meaning assigned to it under clause (x) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, clause (j) of sub-regulation(1) of regulation 2 of the Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008, clause (p) of sub regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013, clause (r) of regulation 2 of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and clause (l) of sub-regulation (1) of regulation 2 of the [Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008, as may be applicable;

(w) "promoter" and "promoter group" shall have the same meaning as assigned to them respectively in clauses (za) and (zb) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

(x) "public" means public as defined under clause (d) of rule 2 of the Securities Contracts (Regulation) Rules, 1957;

(y) "public shareholding" means public shareholding as defined under clause (e) of rule 2 of the Securities Contracts (Regulation) Rules, 1957;

(z) “quarter” means the period of three months commencing on the first day of April, July, October or January of a financial year;

(za) "quarterly results" means the financial results prepared in accordance with these regulations in respect of a quarter;

(zb) “related party” means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards:

Provided that any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more of shareholding in the listed entity shall be deemed to be a related party.

Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);

(zc) “related party transaction” means a transfer of resources, services or obligations between a listed entity and a related party, regardless of whether a price is charged and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract:

Provided that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);

(zd) “relative” means relative as defined under sub-section (77) of section 2 of the Companies Act, 2013 and rules prescribed there under:

Provided this definition shall not be applicable for the units issued by mutual fund which are listed on a recognised stock exchange(s);

(ze) "schedule" means a schedule annexed to these regulations;

(zf) "securities laws" means the Act, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996, and the provisions of the Companies Act, 1956 and Companies Act, 2013, and the rules, regulations, circulars or guidelines made thereunder.

(zg) “securitized debt instruments” shall have the meaning assigned to it under the Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008;

(zga) “security receipts” shall have the meaning assigned to it under the Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008;

(zh) “servicer” means servicer as defined under clause(t) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008;

(zi) "small and medium enterprises" or "SME" shall mean an entity which has issued specified securities in accordance with the provisions of Chapter XB of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(zj) “SME Exchange” means an SME exchange as defined under clause (c) of sub regulation (1) of regulation 106N of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(zk) "stock exchange" means a recognised stock exchange as defined under clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956;

(zl) ‘specified securities’ means ‘equity shares’ and ‘convertible securities’ as defined under clause (zj) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

(zm) “subsidiary” means a subsidiary as defined under sub-section (87) of section 2 of the Companies Act, 2013;

(2) All other words and expressions used but not defined in these regulations, but defined in the Act or the Companies Act, 2013, the Securities Contracts (Regulation) Act, 1956, the Depositories Act, 1996 and/or the rules and regulations made there under shall have the same meaning as respectively assigned to them in such Acts or rules or regulations or any statutory modification or re-enactment thereto, as the case may be.

Applicability of the regulations

3. Unless otherwise provided, these regulations shall apply to the listed entity who has listed any of the following designated securities on recognised stock exchange(s):

(a) specified securities listed on main board or SME Exchange or institutional trading platform;

(b) non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non-cumulative preference shares;

(c) Indian depository receipts;

(d) securitised debt instruments;

(da) security receipts;

(e) units issued by mutual funds;

(f) any other securities as may be specified by the Board.

CHAPTER II

PRINCIPLES GOVERNING DISCLOSURES AND OBLIGATIONS OF LISTED ENTITY

Principles governing disclosures and obligations

4. (1) The listed entity which has listed securities shall make disclosures and abide by its obligations under these regulations, in accordance with the following principles:

(a) Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.

(b) The listed entity shall implement the prescribed accounting standards in letter and spirit in the preparation of financial statements taking into consideration the interest of all stakeholders and shall also ensure that the annual audit is conducted by an independent, competent and qualified auditor.

(c) The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange(s) and investors is not misleading.

(d) The listed entity shall provide adequate and timely information to recognised stock exchange(s) and investors.

(e) The listed entity shall ensure that disseminations made under provisions of these regulations and circulars made there under, are adequate, accurate, explicit, timely and presented in a simple language.

(f) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by investors.

(g) The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by the Board and the recognised stock exchange(s) in this regard and as may be applicable.

(h) The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.

(i) Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information.

(j) Periodic filings, reports, statements, documents and information reports shall contain information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.

(2) The listed entity which has listed its specified securities shall comply with the corporate governance provisions as specified in chapter IV which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below.

(a) **The rights of shareholders**: The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

(i) right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.

(ii) opportunity to participate effectively and vote in general shareholder meetings.

(iii) being informed of the rules, including voting procedures that govern general shareholder meetings.

(iv) opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

(v) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.

(vi) exercise of ownership rights by all shareholders, including institutional investors.

(vii) adequate mechanism to address the grievances of the shareholders.

(viii) protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

(b) **Timely information**: The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

(i) sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.

(ii) Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.

(iii) rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

(c) **Equitable treatment**: The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

(i) All shareholders of the same series of a class shall be treated equally.

(ii) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.

(iii) Exercise of voting rights by foreign shareholders shall be facilitated.

(iv) The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.

(v) Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.

(vi) Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.

(d) **Role of stakeholders in corporate governance:** The listed entity shall recognise the rights of its stakeholders and encourage co-operation between listed entity and the stakeholders, in the following manner:

(i) The listed entity shall respect the rights of stakeholders that are established by law or through mutual agreements.

(ii) Stakeholders shall have the opportunity to obtain effective redress for violation of their rights.

(iii) Stakeholders shall have access to relevant, sufficient and reliable information on a timely and regular basis to enable them to participate in corporate governance process.

(iv) The listed entity shall devise an effective whistle blower mechanism enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

(e) **Disclosure and transparency:** The listed entity shall ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the listed entity, in the following manner:

(i) Information shall be prepared and disclosed in accordance with the prescribed standards of accounting, financial and non-financial disclosure.

(ii) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by users.

(iii) Minutes of the meeting shall be maintained explicitly recording dissenting opinions, if any.

(f) **Responsibilities of the board of directors:** The board of directors of the listed entity shall have the following responsibilities:

(i) Disclosure of information:

(1) Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the listed entity.

(2) The board of directors and senior management shall conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture of good decision-making.

(ii) Key functions of the board of directors-

(1) Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans, setting performance objectives, monitoring implementation and corporate performance, and overseeing major capital expenditures, acquisitions and divestments.

(2) Monitoring the effectiveness of the listed entity's governance practices and making changes as needed.

(3) Selecting, compensating, monitoring and, when necessary, replacing key managerial personnel and overseeing succession planning.

(4) Aligning key managerial personnel and remuneration of board of directors with the longer term interests of the listed entity and its shareholders.

(5) Ensuring a transparent nomination process to the board of directors with the diversity of thought, experience, knowledge, perspective and gender in the board of directors.

(6) Monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions.

(7) Ensuring the integrity of the listed entity's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

(8) Overseeing the process of disclosure and communications.

(9) Monitoring and reviewing board of director's evaluation framework.

(iii) Other responsibilities:

(1) The board of directors shall provide strategic guidance to the listed entity, ensure effective monitoring of the management and shall be accountable to the listed entity and the shareholders.

(2) The board of directors shall set a corporate culture and the values by which executives throughout a group shall behave.

(3) Members of the board of directors shall act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the listed entity and the shareholders.

(4) The board of directors shall encourage continuing directors training to ensure that the members of board of directors are kept up to date.

(5) Where decisions of the board of directors may affect different shareholder groups differently, the board of directors shall treat all shareholders fairly.

(6) The board of directors shall maintain high ethical standards and shall take into account the interests of stakeholders.

(7) The board of directors shall exercise objective independent judgement on corporate affairs.

(8) The board of directors shall consider assigning a sufficient number of nonexecutive members of the board of directors capable of exercising independent judgement to tasks where there is a potential for conflict of interest.

(9) The board of directors shall ensure that, while rightly encouraging positive thinking, these do not result in over-optimism that either leads to significant risks not being recognised or exposes the listed entity to excessive risk.

(10) The board of directors shall have ability to 'step back' to assist executive management by challenging the assumptions underlying: strategy, strategic initiatives (such as acquisitions), risk appetite, exposures and the key areas of the listed entity's focus.

(11) When committees of the board of directors are established, their mandate, composition and working procedures shall be well defined and disclosed by the board of directors.

(12) Members of the board of directors shall be able to commit themselves effectively to their responsibilities.

(13) In order to fulfil their responsibilities, members of the board of directors shall have access to accurate, relevant and timely information.

(14) The board of directors and senior management shall facilitate the independent directors to perform their role effectively as a member of the board of directors and also a member of a committee of board of directors.

(3) In case of any ambiguity or incongruity between the principles and relevant regulations, the principles specified in this Chapter shall prevail.

CHAPTER III

COMMON OBLIGATON OF LISTED ENTITES

General obligation of compliance.

5. The listed entity shall ensure that key managerial personnel, directors, promoters or any other person dealing with the listed entity, complies with responsibilities or obligations, if any, assigned to them under these regulations.

Compliance Officer and his Obligations.

6. (1) A listed entity shall appoint a qualified company secretary as the compliance officer.

(2) The compliance officer of the listed entity shall be responsible for-

(a) ensuring conformity with the regulatory provisions applicable to the listed entity in letter and spirit.

(b) co-ordination with and reporting to the Board, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in manner as specified from time to time.

(c) ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations.

(d) monitoring email address of grievance redressal division as designated by the listed entity for the purpose of registering complaints by investors:

Provided that the requirements of this regulation shall not be applicable in the case of units issued by mutual funds which are listed on recognised stock exchange(s) but shall be governed by the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

Share Transfer Agent

7. (1) The listed entity shall appoint a share transfer agent or manage the share transfer facility in-house:

Provided that, in the case of in-house share transfer facility, as and when the total number of holders of securities of the listed entity exceeds one lakh, the listed entity shall either register with the Board as a Category II share transfer agent or appoint Registrar to an issue and share transfer agent registered with the Board.

(2) The listed entity shall ensure that all activities in relation to 11 share transfer facility are maintained either in house or by Registrar to an issue and share transfer agent registered with the Board.

(3) The listed entity shall submit a compliance certificate to the exchange, duly signed by both the compliance officer of the listed entity and the authorised representative of the share transfer agent, wherever applicable, within one month of end of each half of the financial year, certifying compliance with the requirements of sub- regulation (2).

(4) In case of any change or appointment of a new share transfer agent, the listed entity shall enter into a tripartite agreement between the existing share transfer agent, the new share transfer agent and the listed entity, in the manner as specified by the Board from time to time:

Provided that in case the existing share transfer facility is managed in-house, the agreement referred above shall be entered into between the listed entity and the new share transfer agent.

(5) The listed entity shall intimate such appointment, referred to in sub-regulation (4), to the stock exchange(s) within seven days of entering into the agreement.

(6) The agreement referred to in sub-regulation (4) shall be placed in the subsequent meeting of the board of directors:

Provided that the requirements of this regulation shall not be applicable to the units issued by mutual funds that are listed on recognised stock exchange(s).

Co-operation with intermediaries registered with the Board.

8. The listed entity, wherever applicable, shall co-operate with and submit correct and adequate information to the intermediaries registered with the Board such as credit rating agencies, registrar to an issue and share transfer agents, debenture trustees etc., within timelines and procedures specified under the Act, regulations and circulars issued there under:

Provided that requirements of this regulation shall not be applicable to the units issued by mutual funds listed on a recognised stock exchange(s) for which the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 shall be applicable.

Preservation of documents.

9. The listed entity shall have a policy for preservation of documents, approved by its board of directors, classifying them in at least two categories as follows-

(a) documents whose preservation shall be permanent in nature;

(b) documents with preservation period of not less than eight years after completion of the relevant transactions:

Provided that the listed entity may keep documents specified in clauses (a) and (b) in electronic mode.

Filing of information

10. (1) The listed entity shall file the reports, statements, documents, filings and any other information with the recognised stock exchange(s) on the electronic platform as specified by the

Board or the recognised stock exchange(s).

(2) The listed entity shall put in place infrastructure as required for compliance with sub-regulation (1).

Scheme of Arrangement

11. The listed entity shall ensure that any scheme of arrangement /amalgamation /merger reconstruction /reduction of capital etc. to be presented to any Court or Tribunal does not in any way violate, override or limit the provisions of securities laws or requirements of the stock exchange(s):

Provided that this regulation shall not be applicable for the units issued by Mutual Fund which are listed on a recognised stock exchange(s).

Payment of dividend or interest or redemption or repayment

12. The listed entity shall use any of the electronic mode of payment facility approved by the Reserve Bank of India, in the manner specified in Schedule I, for the payment of the following:

(a) dividends;

(b) interest;

(c) redemption or repayment amounts:

Provided that where it is not possible to use electronic mode of payment, 'payable-at-par' warrants or cheques may be issued:

Provided further that where the amount payable as dividend exceeds one thousand and five hundred rupees, the 'payable-at-par' warrants or cheques shall be sent by speed post.

Grievance Redressal Mechanism

13. (1) The listed entity shall ensure that adequate steps are taken for expeditious redressal of investor complaints.

(2) The listed entity shall ensure that it is registered on the SCORES platform or such other electronic platform or system of the Board as shall be mandated from time to time, in order to handle investor complaints electronically in the manner specified by the Board.

(3) The listed entity shall file with the recognised stock exchange(s) on a quarterly basis, within twenty one days from the end of each quarter, a statement giving the number of investor complaints pending at the beginning of the quarter, those received during the quarter, disposed of during the quarter and those remaining unresolved at the end of the quarter.

(4) The statement as specified in sub-regulation (3) shall be placed, on quarterly basis, before the board of directors of the listed entity.

Fees and other charges to be paid to the recognized stock exchange(s)

14. The listed entity shall pay all such fees or charges, as applicable, to the recognised stock exchange(s), in the manner specified by the Board or the recognised stock exchange(s).

CHAPTER IV

OBLIGATIONS OF LISTED ENTITY WHICH HAS LISTED ITS SPECIFIED SECURITIES

Applicability

15. (1) The provisions of this chapter shall apply to a listed entity which has listed its specified securities on any recognised stock exchange(s) either on the main board or on SME Exchange or on institutional trading platform:

(2) The compliance with the corporate governance provisions as specified in regulations 17, 17A, 18, 19, 20, 21,22, 23, 24, 24A, 25, 26, 27 and clauses (b) to (i) of sub-regulation (2) of regulation 46 and para C , D and E of Schedule V shall not apply, in respect of –

(a) the listed entity having paid up equity share capital not exceeding rupees ten crore and net worth not exceeding rupees twenty five crore, as on the last day of the previous financial year:

Provided that where the provisions of the regulations specified in this regulation becomes applicable to a listed entity at a later date, such listed entity shall comply with the requirements those regulations within six months from the date on which the provisions became applicable to the listed entity.

(b) the listed entity which has listed its specified securities on the SME Exchange:

Provided that for other listed entities which are not companies, but body corporate or are subject to regulations under other statues, the provisions of corporate governance provisions as specified in regulation 17, 17A, 18, 19, 20, 21, 22, 23, 24, 24A, 25, 26, 27 and clauses (b) to (i) of sub-regulation (2) of regulation 46 and para C , D and E of Schedule V shall apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant authorities.

(2A) The provisions as specified in regulation 17 shall not be applicable during the insolvency resolution process period in respect of a listed entity which is undergoing corporate insolvency resolution process under the Insolvency Code:

Provided that the role and responsibilities of the board of directors as specified under regulation 17 shall be fulfilled by the interim resolution professional or resolution professional in accordance with sections 17 and 23 of the Insolvency Code.

(2B) The provisions as specified in regulations 18, 19, 20 and 21 shall not be applicable during the insolvency resolution process period in respect of a listed entity which is undergoing corporate insolvency resolution process under the Insolvency Code:

Provided that the roles and responsibilities of the committees specified in the respective regulations shall be fulfilled by the interim resolution professional or resolution professional.

Definitions

16. (1) For the purpose of this chapter, unless the context otherwise requires -

(a) "control" shall have the same meaning as assigned to it under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

(b) "independent director" means a non-executive director, other than a nominee director of the listed entity:

(i) who, in the opinion of the board of directors, is a person of integrity and possesses relevant expertise and experience;

(ii) who is or was not a promoter of the listed entity or its holding, subsidiary or associate company or member of the promoter group of the listed entity;

(iii) who is not related to promoters or directors in the listed entity, its holding, subsidiary or associate company;

(iv) who, apart from receiving director's remuneration, has or had no material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(v) none of whose relatives has or had pecuniary relationship or transaction with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed from time to time, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vi) who, neither himself, nor whose relative(s) —

(A) holds or has held the position of a key managerial personnel or is or has been an employee of the listed entity or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

(B) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of —

(1) a firm of auditors or company secretaries in practice or cost auditors of the listed entity or its holding, subsidiary or associate company; or

(2) any legal or a consulting firm that has or had any transaction with the listed entity, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

(C) holds together with his relatives two per cent or more of the total voting power of the listed entity; or

(D) is a chief executive or director, by whatever name called, of any nonprofit organisation that receives twenty-five per cent or more of its

(E) is a material supplier, service provider or customer or a lessor or lessee of the listed entity;

(vii) who is not less than 21 years of age.

(viii) who is not a non-independent director of another company on the board of which any non-independent director of the listed entity is an independent director:

(c) "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds ten percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

Explanation.- The listed entity shall formulate a policy for determining 'material' subsidiary.

(d) "senior management" shall mean officers/personnel of the listed entity who are members of its core management team excluding board of directors and normally this shall comprise all members of management one level below the 20 "chief executive officer/managing director/whole time director/manager (including chief executive officer/manager, in case they are not part of the board) and shall specifically include company secretary and chief financial officer.

Board of Directors

17. (1) The composition of board of directors of the listed entity shall be as follows:

(a) board of directors shall have an optimum combination of executive and nonexecutive directors with at least one woman director and not less than fifty per cent. of the board of directors shall comprise of non-executive directors;

Provided that the Board of directors of the top 500 listed entities shall have at least one independent woman director by April 1, 2019 and the Board of directors of the top 1000 listed entities shall have at least one independent woman director by April 1, 2020;

Explanation: The top 500 and 1000 entities shall be determined on the basis of market capitalization, as at the end of the immediate previous financial year.

(b) where the chairperson of the board of directors is a non-executive director, at least one-third of the board of directors shall comprise of independent directors and where the listed entity does not have a regular non-executive chairperson, at least half of the board of directors shall comprise of independent directors:

Provided that where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, at least half of the board of directors of the listed entity shall consist of independent directors.

Explanation. - For the purpose of this clause, the expression "related to any promoter" shall have the following meaning:

(i) if the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

(ii) if the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

(c) The board of directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors.

Explanation: The top 1000 and 2000 entities shall be determined on the basis of market capitalisation as at the end of the immediate previous financial year.

(1A) No listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy five years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

(1B). With effect from April 1, 2020, the top 500 listed entities shall ensure that the Chairperson of the board of such listed entity shall –

(a) be a non-executive director;

(b) not be related to the Managing Director or the Chief Executive Officer as per the definition of the term "relative" defined under the Companies Act, 2013:

Provided that this sub-regulation shall not be applicable to the listed entities which do not have any identifiable promoters as per the shareholding pattern filed with stock exchanges.

Explanation - The top 500 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

(2) The board of directors shall meet at least four times a year, with a maximum time gap of one hundred and twenty days between any two meetings.

(2A) The quorum for every meeting of the board of directors of the top 1000 listed entities with effect from April 1, 2019 and of the top 2000 listed entities with effect from April 1, 2020 shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director.

Explanation I – For removal of doubts, it is clarified that the participation of the directors by video conferencing or by other audio-visual means shall also be counted for the purposes of such quorum.

Explanation II - The top 1000 and 2000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

(3) The board of directors shall periodically review compliance reports pertaining to all laws applicable to the listed entity, prepared by the listed entity as well as steps taken by the listed entity to rectify instances of non-compliances.

(4) The board of directors of the listed entity shall satisfy itself that plans are in place for orderly succession for appointment to the board of directors and senior management.

(5) (a) The board of directors shall lay down a code of conduct for all members of board of directors and senior management of the listed entity.

(b) The code of conduct shall suitably incorporate the duties of independent directors as laid down in the Companies Act, 2013.

(6) (a) The board of directors shall recommend all fees or compensation, if any, paid to non-executive directors, including independent directors and shall require approval of shareholders in general meeting.

(b) The requirement of obtaining approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 2013 for payment of sitting fees without approval of the Central Government.

(c) The approval of shareholders mentioned in clause (a), shall specify the limits for the maximum number of stock options that may be granted to non-executive directors, in any financial year and in aggregate.

(ca) The approval of shareholders by special resolution shall be obtained every year, in which the annual remuneration payable to a single non-executive director exceeds fifty per cent of the total annual remuneration payable to all non-executive directors, giving details of the remuneration thereof.

(d) Independent directors shall not be entitled to any stock option.

(e) The fees or compensation payable to executive directors who are promoters or members of the promoter group, shall be subject to the approval of the shareholders by special resolution in general meeting, if-

(i) the annual remuneration payable to such executive director exceeds rupees 5 crore or 2.5 per cent of the net profits of the listed entity, whichever is higher; or

(ii) where there is more than one such director, the aggregate annual remuneration to such directors exceeds 5 per cent of the net profits of the listed entity:

Provided that the approval of the shareholders under this provision shall be valid only till the expiry of the term of such director.

Explanation: For the purposes of this clause, net profits shall be calculated as per section 198 of the Companies Act, 2013.

(7) The minimum information to be placed before the board of directors is specified in **Part A of Schedule II**.

(8) The chief executive officer and the chief financial officer shall provide the compliance certificate to the board of directors as specified in Part B of Schedule II.

(9) (a) The listed entity shall lay down procedures to inform members of board of directors about risk assessment and minimization procedures.

(b) The board of directors shall be responsible for framing, implementing and monitoring the risk management plan for the listed entity.

(10) The evaluation of independent directors shall be done by the entire board of directors which shall include -

(a) performance of the directors; and

(b) fulfillment of the independence criteria as specified in these regulations and their independence from the management:

Provided that in the above evaluation, the directors who are subject to evaluation shall not participate.

(11). The statement to be annexed to the notice as referred to in sub-section (1) of section 102 of the Companies Act, 2013 for each item of special business to be transacted at a general meeting shall also set forth clearly the recommendation of the board to the shareholders on each of the specific items.

Maximum number of directorships

17A. The directors of listed entities shall comply with the following conditions with respect to the maximum number of directorships, including any alternate directorships that can be held by them at any point of time -

(1) A person shall not be a director in more than eight listed entities with effect from April 1, 2019 and in not more than seven listed entities with effect from April 1, 2020:

Provided that a person shall not serve as an independent director in more than seven listed entities.

(2) Notwithstanding the above, any person who is serving as a whole time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities.

For the purpose of this sub-regulation, the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange.

Audit Committee.

18. (1) Every listed entity shall constitute a qualified and independent audit committee in accordance with the terms of reference, subject to the following:

(a) The audit committee shall have minimum three directors as members.

(b) Two-thirds of the members of audit committee shall be independent directors.

(c) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

Explanation (1) - For the purpose of this regulation, "financially literate" shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (2) - For the purpose of this regulation , a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(d) The chairperson of the audit committee shall be an independent director and he shall be present at Annual general meeting to answer shareholder queries.

(e) The Company Secretary shall act as the secretary to the audit committee.

(f) The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee:

Provided that occasionally the audit committee may meet without the presence of any executives of the listed entity.

(2) The listed entity shall conduct the meetings of the audit committee in the following manner:

(a) The audit committee shall meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings.

(b) The quorum for audit committee meeting shall either be two members or one third of the members of the audit committee, whichever is greater, with at least two independent directors.

(c) The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

(3) The role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II.

Nomination and remuneration committee

19.(1) The board of directors shall constitute the nomination and remuneration committee as follows:

(a) the committee shall comprise of at least three directors ;

(b) all directors of the committee shall be non-executive directors; and

(c) at least fifty percent of the directors shall be independent directors.

(2) The Chairperson of the nomination and remuneration committee shall be an independent director:

Provided that the chairperson of the listed entity, whether executive or non-executive, may be appointed as a member of the Nomination and Remuneration Committee and shall not chair such Committee.

(2A) The quorum for a meeting of the nomination and remuneration committee shall be either two members or one third of the members of the committee, whichever is greater, including at least one independent director in attendance.

(3) The Chairperson of the nomination and remuneration committee may be present at the annual general meeting, to answer the shareholders' queries; however, it shall be up to the chairperson to decide who shall answer the queries.

(3A) The nomination and remuneration committee shall meet at least once in a year

(4) The role of the nomination and remuneration committee shall be as specified as in Part D of the Schedule II.

Stakeholders Relationship Committee

20. (1) The listed entity shall constitute a Stakeholders Relationship Committee to specifically look into various aspects of interest of shareholders, debenture holders and other security holders.

(2) The chairperson of this committee shall be a non-executive director.

(2A) At least three directors, with at least one being an independent director, shall be members of the Committee.

(3) The Chairperson of the Stakeholders Relationship Committee shall be present at the annual general meetings to answer queries of the security holders.

(3A) The stakeholders relationship committee shall meet at least once in a year.

(4) The role of the Stakeholders Relationship Committee shall be as specified as in **Part D of the Schedule II.**

Risk Management Committee

21. (1) The board of directors shall constitute a Risk Management Committee.

(2) The majority of members of Risk Management Committee shall consist of members of the board of directors.

(3) The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.

(3A) The risk management committee shall meet at least once in a year.

(4) The board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit such function shall specifically cover cyber security.

(5) The provisions of this regulation shall be applicable to top 500 listed entities determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

Vigil mechanism

22. (1) The listed entity shall formulate a vigil mechanism for directors and employees to report genuine concerns.

(2) The vigil mechanism shall provide for adequate safeguards against victimization of director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

Related party transactions

23. (1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly:

Explanation - A transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

(1A) Notwithstanding the above, with effect from July 01, 2019 a transaction involving payments made to a related party with respect to brand usage or royalty shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceed two percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

(2) All related party transactions shall require prior approval of the audit committee.

(3) Audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions, namely-

(a) the audit committee shall lay down the criteria for granting the omnibus approval in line with the policy on related party transactions of the listed entity and such approval shall be applicable in respect of transactions which are repetitive in nature;

(b) the audit committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity;

(c) the omnibus approval shall specify:

(i) the name(s) of the related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into,

(ii) the indicative base price / current contracted price and the formula for variation in the price if any; and

(iii) such other conditions as the audit committee may deem fit:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may grant omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

(d) the audit committee shall review, at least on a quarterly basis, the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.

(e) Such omnibus approvals shall be valid for a period not exceeding one year and shall require fresh approvals after the expiry of one year:

(4) All material related party transactions shall require approval of the shareholders through resolution and no related party shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not:

Provided that the requirements specified under this sub-regulation shall not apply in respect of a resolution plan approved under section 31 of the Insolvency Code, subject to

(5) The provisions of sub-regulations (2), (3) and (4) shall not be applicable in the following cases:

(a) transactions entered into between two government companies;

(b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

Explanation. - For the purpose of clause (a), "government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.

(6) The provisions of this regulation shall be applicable to all prospective transactions.

(7) For the purpose of this regulation, all entities falling under the definition of related parties shall 45 not vote to approve the relevant transaction irrespective of whether the entity is a party to the particular transaction or not.

(8) All existing material related party contracts or arrangements entered into prior to the date of notification of these regulations and which may continue beyond such date shall be placed for approval of the shareholders in the first General Meeting subsequent to notification of these regulations.

(9) The listed entity shall submit within 30 days from the date of publication of its standalone and consolidated financial results for the half year, disclosures of related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website.

Corporate governance requirements with respect to subsidiary of listed entity

24. (1) At least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

Explanation - For the purposes of this provision, notwithstanding anything to the contrary contained in regulation 16, the term “material subsidiary” shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year.

(2) The audit committee of the listed entity shall also review the financial statements, in particular, the investments made by the unlisted subsidiary.

(3) The minutes of the meetings of the board of directors of the unlisted subsidiary shall be placed at the meeting of the board of directors of the listed entity.

(4) The management of the unlisted subsidiary shall periodically bring to the notice of the board of directors of the listed entity, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary.

Explanation - For the purpose of this regulation, the term “significant transaction or arrangement” shall mean any individual transaction or arrangement that exceeds or is likely to exceed ten percent of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the unlisted subsidiary for the immediately preceding accounting year.

(5) A listed entity shall not dispose of shares in its material subsidiary resulting in reduction of its shareholding (either on its own or together with other subsidiaries) to less than fifty percent or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting except in cases where such divestment is made under a scheme of arrangement duly approved by a Court/Tribunal or under a resolution plan duly approved under section 31 of the Insolvency Code and such an event is disclosed to the recognized stock exchanges within one day of the resolution plan being approved 49.

(6) Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary on an aggregate basis during a financial year shall require prior approval of shareholders by way of special resolution, unless the sale/disposal/lease is made under a scheme of arrangement duly approved by a Court/Tribunal or under a resolution plan duly approved under section 31 of the Insolvency Code and such an event is disclosed to the recognized stock exchanges within one day of the resolution plan being approved.

(7) Where a listed entity has a listed subsidiary, which is itself a holding company, the provisions of this regulation shall apply to the listed subsidiary in so far as its subsidiaries are concerned.

Secretarial Audit

24 A. Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex with its annual report, a secretarial audit report, given by a company secretary in practice, in such form as may be specified with effect from the year ended March 31, 2019.

Obligations with respect to independent directors.

25. (1) No person shall be appointed or continue as an alternate director for an independent director of a listed entity with effect from October 1, 2018.

(2) The maximum tenure of independent directors shall be in accordance with the Companies Act, 2013 and rules made there under, in this regard, from time to time.

(3) The independent directors of the listed entity shall hold at least one meeting in a year, without the presence of non-independent directors and members of the management and all the independent directors shall strive to be present at such meeting.

(4) The independent directors in the meeting referred in sub-regulation (3) shall, inter alia-

(a) review the performance of non-independent directors and the board of directors as a whole;

(b) review the performance of the chairperson of the listed entity, taking into account the views of executive directors and non-executive directors;

(c) assess the quality, quantity and timeliness of flow of information between the management of the listed entity and the board of directors that is necessary for the board of directors to effectively and reasonably perform their duties.

(5) An independent director shall be held liable, only in respect of such acts of omission or commission by the listed entity which had occurred with his knowledge, attributable through processes of board of directors, and with his consent or connivance or where he had not acted diligently with respect to the provisions contained in these regulations.

(6) An independent director who resigns or is removed from the board of directors of the listed entity shall be replaced by a new independent director by listed entity at the earliest but not later than the immediate next meeting of the board of directors or three months from the date of such vacancy, whichever is later:

Provided that where the listed entity fulfils the requirement of independent directors in its board of directors without filling the vacancy created by such resignation or removal, the requirement of replacement by a new independent director shall not apply.

(7) The listed entity shall familiarize the independent directors through various programmes about the listed entity, including the following:

(a) nature of the industry in which the listed entity operates;

(b) business model of the listed entity;

(c) roles, rights, responsibilities of independent directors; and

(d) any other relevant information.

(8) Every independent director shall, at the first meeting of the board in which he participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, submit a declaration that he meets the criteria of independence as provided in clause (b) of sub-regulation (1) of regulation 16 and that he is not aware of any circumstance or situation, which exist or may be reasonably anticipated, that could impair or impact his ability to discharge his duties with an objective independent judgment and without any external influence.

(9) The board of directors of the listed entity shall take on record the declaration and confirmation submitted by the independent director under sub-regulation (8) after undertaking due assessment of the veracity of the same.

(10) With effect from October 1, 2018, the top 500 listed entities by market capitalization calculated as on March 31 of the preceding financial year, shall undertake Directors and Officers

insurance ('D and O insurance') for all their independent directors of such quantum and for such risks as may be determined by its board of directors.

Obligations with respect to employees including senior management, key managerial persons, directors and promoters.

26. (1) A director shall not be a member in more than ten committees or act as chairperson of more than five committees across all listed entities in which he is a director which shall be determined as follows:

(a) the limit of the committees on which a director may serve in all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies and companies under Section 8 of the Companies Act, 2013 shall be excluded;

(b) for the purpose of determination of limit, chairpersonship and membership of the audit committee and the Stakeholders' Relationship Committee alone shall be considered.

(2) Every director shall inform the listed entity about the committee positions he or she occupies in other listed entities and notify changes as and when they take place.

(3) All members of the board of directors and senior management personnel shall affirm compliance with the code of conduct of board of directors and senior management on an annual basis.

(4) Non-executive directors shall disclose their shareholding, held either by them or on a beneficial basis for any other persons in the listed entity in which they are proposed to be appointed as directors, in the notice to the general meeting called for appointment of such director.

(5) Senior management shall make disclosures to the board of directors relating to all material, financial and commercial transactions, where they have personal interest that may have a potential conflict with the interest of the listed entity at large.

Explanation.- For the purpose of this sub-regulation, conflict of interest relates to dealing in the shares of listed entity, commercial dealings with bodies, which have shareholding of management and their relatives etc.

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

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

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

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

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

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

Other corporate governance requirements

27. (1) The listed entity may, at its discretion, comply with requirements as specified in Part E of Schedule II.

(2) (a) The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within fifteen days from close of the quarter.

(b) Details of all material transactions with related parties shall be disclosed along with the report mentioned in clause (a) of sub-regulation (2).

(c) The report mentioned in clause (a) of sub-regulation (2) shall be signed either by the compliance officer or the chief executive officer of the listed entity.

In-principle approval of recognized stock exchange(s)

28. (1) The listed entity, before issuing securities, shall obtain an 'in-principle' approval from recognised stock exchange(s) in the following manner:

(a) where the securities are listed only on recognised stock exchange(s) having nationwide trading terminals, from all such stock exchange(s);

(b) where the securities are not listed on any recognised stock exchange having nationwide trading terminals, from all the stock exchange(s) in which the securities of the issuer are proposed to be listed;

(c) where the securities are listed on recognised stock exchange(s) having nationwide trading terminals as well as on the recognised stock exchange(s) not having nationwide trading terminals, from all recognised stock exchange(s) having nationwide trading terminals:

(2) The requirement of obtaining in-principle approval from recognised stock exchange(s), shall not be applicable for securities issued pursuant to the scheme of arrangement for which the listed entity has already obtained No-Objection Letter from recognised stock exchange(s) in accordance with regulation 37.

Prior Intimations

29. (1) The listed entity shall give prior intimation to stock exchange about the meeting of the board of directors in which any of the following proposals is due to be considered:

(a) financial results viz. quarterly, half yearly, or annual, as the case may be;

(b) proposal for buyback of securities;

(c) proposal for voluntary delisting by the listed entity from the stock exchange(s);

(d) fund raising by way of further public offer, rights issue, American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds, qualified institutions placement, debt issue, preferential issue or any other method and for determination of issue price:

Provided that intimation shall also be given in case of any annual general meeting or extraordinary general meeting or postal ballot that is proposed to be held for obtaining shareholder approval for further fund raising indicating type of issuance.

(e) declaration/ recommendation of dividend, issue of convertible securities including convertible debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend.

(f) the proposal for declaration of bonus securities where such proposal is communicated to the board of directors of the listed entity as part of the agenda papers:

(2) The intimation required under sub-regulation (1), shall be given at least two working days in advance, excluding the date of the intimation and date of the meeting:

Provided that intimation regarding item specified in clause (a) of sub-regulation (1), to be discussed at the meeting of board of directors shall be given at least five days in advance (excluding the date of the intimation and date of the meeting), and such intimation shall include the date of such meeting of board of directors.

(3) The listed entity shall give intimation to the stock exchange(s) at least eleven working days before any of the following proposal is placed before the board of directors -

(a) any alteration in the form or nature of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof.

(b) any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

Disclosure of events or information

30. (1) Every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material.

(2) Events specified in Para A of Part A of Schedule III are deemed to be material events and listed entity shall make disclosure of such events.

(3) The listed entity shall make disclosure of events specified in Para B of Part A of Schedule III, based on application of the guidelines for materiality, as specified in sub-regulation (4).

(4) (i) The listed entity shall consider the following criteria for determination of materiality of events/ information:

(a) the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or

(b) the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date;

(c) In case where the criteria specified in sub-clauses (a) and (b) are not applicable, an event/information may be treated as being material if in the opinion of the board of directors of listed entity, the event / information is considered material.

(ii) The listed entity shall frame a policy for determination of materiality, based on criteria specified in this sub-regulation, duly approved by its board of directors, which shall be disclosed on its website.

(5) The board of directors of the listed entity shall authorize one or more Key Managerial Personnel for the purpose of determining materiality of an event or information and for the purpose of making disclosures to stock exchange(s) under this regulation and the contact details of such personnel shall be also disclosed to the stock exchange(s) and as well as on the listed entity's website.

(6) The listed entity shall first disclose to stock exchange(s) of all events, as specified in Part A of Schedule III, or information as soon as reasonably possible and not later than twenty four hours from the occurrence of event or information:

Provided that in case the disclosure is made after twenty four hours of occurrence of the event or information, the listed entity shall, along with such disclosures provide explanation for delay:

Provided further that disclosure with respect to events specified in sub-para 4 of Para A of Part A of Schedule III shall be made within thirty minutes of the conclusion of the board meeting.

(7) The listed entity shall, with respect to disclosures referred to in this regulation, make disclosures updating material developments on a regular basis, till such time the event is resolved/closed, with relevant explanations.

(8) The listed entity shall disclose on its website all such events or information which has been disclosed to stock exchange(s) under this regulation and such disclosures shall be hosted on the website of the listed entity for a minimum period of five years and thereafter as per the archival policy of the listed entity, as disclosed on its website.

(9) The listed entity shall disclose all events or information with respect to subsidiaries which are material for the listed entity.

(10) The listed entity shall provide specific and adequate reply to all queries raised by stock exchange(s) with respect to any events or information:

Provided that the stock exchange(s) shall disseminate information and clarification as soon as reasonably practicable.

(11) The listed entity may on its own initiative also, confirm or deny any reported event or information to stock exchange(s).

(12) In case where an event occurs or an information is available with the listed entity, which has not been indicated in Para A or B of Part A of Schedule III, but which may have material effect on it, the listed entity is required to make adequate disclosures in regard thereof.

Holding of specified securities and shareholding pattern.

31. (1) The listed entity shall submit to the stock exchange(s) a statement showing holding of securities and shareholding pattern separately for each class of securities, in the format specified by the Board from time to time within the following timelines -

(a) one day prior to listing of its securities on the stock exchange(s);

(b) on a quarterly basis, within twenty one days from the end of each quarter; and,

(c) within ten days of any capital restructuring of the listed entity resulting in a change exceeding two per cent of the total paid-up share capital:

Provided that in case of listed entities which have listed their specified securities on SME Exchange, the above statements shall be submitted on a half yearly basis within twenty one days from the end of each half year.

(2) The listed entity shall ensure that hundred percent of shareholding of promoter(s) and promoter group is in dematerialized form and the same is maintained on a continuous basis in the manner as specified by the Board.

(3) The listed entity shall comply with circulars or directions issued by the Board from time to time with respect to maintenance of shareholding in dematerialized form.

(4) All entities falling under promoter and promoter group shall be disclosed separately in the shareholding pattern appearing on the website of all stock exchanges having nationwide trading terminals where the specified securities of the entity are listed, in accordance with the formats specified by the Board.

Conditions for re-classification of any person as promoter / public

31A. (1) For the purpose of this regulation:

(a) "promoter(s) seeking re-classification" shall mean all such promoters/persons belonging to the promoter group seeking re-classification of status as public.

(b) "persons related to the promoter(s) seeking re-classification" shall mean such persons with respect to that promoter(s) seeking re-classification who fall under sub-clauses (ii), (iii) and (iv) of clause (pp) of sub-regulation (1) of regulation 2 of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

(2) Re-classification of the status of any person as a promoter or public shall be permitted by the stock exchanges only upon receipt of an application from the listed entity along with all relevant documents subject to compliance with conditions specified in these regulations;

Provided that in case of entities listed on more than one stock exchange, the concerned stock exchanges shall jointly decide on the application.

(3) Re-classification of status of a promoter/ person belonging to promoter group to public shall be permitted by the stock exchanges only upon satisfaction of the following conditions:

(a) an application for re-classification to the stock exchanges has been made by the listed entity consequent to the following procedures and not later than thirty days from the date of approval by shareholders in general meeting:

(i) the promoter(s) seeking re-classification shall make a request for reclassification to the listed entity which shall include rationale for seeking such re-classification and how the conditions specified in clause (b) below are satisfied;

(ii) the board of directors of the listed entity shall analyze the request and place the same before the shareholders in a general meeting for approval along with the views of the board of directors on the request:

Provided that there shall be a time gap of at least three months but not exceeding six months between the date of board meeting and the shareholder's meeting considering the request of the promoter(s) seeking re-classification.

(iii) the request of the promoter(s) seeking re-classification shall be approved in the general meeting by an ordinary resolution in which the promoter(s) seeking re-classification and persons related to the promoter(s) seeking re-classification shall not vote to approve such re-classification request.

(b) the promoter(s) seeking re-classification and persons related to the promoter(s) seeking re-classification shall not:

(i) together, hold more than ten percent of the total voting rights in the listed entity;

(ii) exercise control over the affairs of the listed entity directly or indirectly;

(iii) have any special rights with respect to the listed entity through formal or informal arrangements including through any shareholder agreements;

(iv) be represented on the board of directors (including not having a nominee director) of the listed entity;

(v) act as a key managerial person in the listed entity;

(vi) be a 'wilful defaulter' as per the Reserve Bank of India Guidelines;

(vii) be a fugitive economic offender.

(c) the listed entity shall:

(i) be compliant with the requirement for minimum public shareholding as required under regulation 38 of these regulations;

(ii) not have trading in its shares suspended by the stock exchanges;

(iii) not have any outstanding dues to the Board, the stock exchanges or the depositories.

(4) The promoter(s) seeking re-classification, subsequent to re-classification as public, shall comply with the following conditions:

(a) he shall continue to comply with conditions mentioned at sub-clauses (i), (ii) and (iii) of clause (b) of sub-regulation 3 as specified above at all times from the date of such re-classification failing which, he shall automatically be reclassified as promoter/ persons belonging to promoter group, as applicable;

(b) he shall comply with conditions mentioned at sub-clauses (iv) and (v) of clause (b) of sub-regulation 3 for a period of not less than three years from the date of such re-classification failing which, he shall automatically be reclassified as promoter/ persons belonging to promoter group, as applicable.

(5) If any public shareholder seeks to re-classify itself as promoter, it shall be required to make an open offer in accordance with the provisions of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

(6) In case of transmission, succession, inheritance and gift of shares held by a promoter/ person belonging to the promoter group:

(a) immediately on such event, the recipient of such shares shall be classified as a promoter/ person belonging to the promoter group, as applicable.

(b) subsequently, in case the recipient classified as a promoter/person belonging to the promoter group proposes to seek re-classification of status as public, it may do so subject to compliance with conditions specified in sub-regulation (3) above.

(c) in case of death of a promoter/person belonging to the promoter group, such person shall automatically cease to be included as a promoter/person belonging to the promoter group.

(7) A listed entity shall be considered as 'listed entity with no promoters' if due to reclassification or otherwise, the entity does not have any promoter;

(8) The following events shall deemed to be material events and shall be disclosed by the listed entity to the stock exchanges as soon as reasonably possible and not later than twenty four hours from the occurrence of the event:

(a) receipt of request for re-classification by the listed entity from the promoter(s) seeking re-classification;

(b) minutes of the board meeting considering such request which would include the views of the board on the request;

(c) submission of application for re-classification of status as promoter/public by the listed entity to the stock exchanges;

(d) decision of the stock exchanges on such application as communicated to the listed entity;

(9) The provisions of sub-regulations 3, 4 and clauses (a) and (b) of sub-regulation 8 of this regulation shall not apply, if re-classification of promoter(s)/ promoter group of the listed entity is as per the resolution plan approved under section 31 of the Insolvency Code, subject to the condition that such promoter(s) seeking reclassification shall not remain in control of the listed entity.

Statement of deviation(s) or variation(s)

32. (1) The listed entity shall submit to the stock exchange the following statement(s) on a quarterly basis for public issue, rights issue, preferential issue etc,-

(a) indicating deviations, if any, in the use of proceeds from the objects stated in the offer document or explanatory statement to the notice for the general meeting, as applicable;

(b) indicating category wise variation (capital expenditure, sales and marketing, working capital etc.) between projected utilisation of funds made by it in its offer document or explanatory statement to the notice for the general meeting, as applicable and the actual utilisation of funds.

(2) The statement(s) specified in sub-regulation (1), shall be continued to be given till such time the issue proceeds have been fully utilised or the purpose for which these proceeds were raised has been achieved.

(3) The statement(s) specified in sub-regulation (1), shall be placed before the audit committee for review and after such review, shall be submitted to the stock exchange(s).

(4) The listed entity shall furnish an explanation for the variation specified in sub-regulation (1), in the directors' report in the annual report.

(5) The listed entity shall prepare an annual statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice, certified by the statutory auditors of the listed entity, and place it before the audit committee till such time the full money raised through the issue has been fully utilized.

(6) Where the listed entity has appointed a monitoring agency to monitor utilisation of proceeds of a public or rights issue, the listed entity shall submit to the stock exchange(s) any comments or report received from the monitoring agency.

(7) Where the listed entity has appointed a monitoring agency to monitor the utilisation of proceeds of a public or rights issue, the monitoring report of such agency shall be placed before the audit committee on an annual basis, promptly upon its receipt.

Explanation- For the purpose of this sub-regulation, "monitoring agency" shall mean the monitoring agency specified in regulation 16 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

(7A) Where an entity has raised funds through preferential allotment or qualified institutions placement, the listed entity shall disclose every year, the utilization of such funds during that year in its Annual Report until such funds are fully utilized.

(8) For the purpose of this regulation, any reference to "quarterly/quarter" in case of listed entity which have listed their specified securities on SME Exchange shall respectively be read as "half yearly/half year".

Financial results

33. (1) While preparing financial results, the listed entity shall comply with the following:

(a) The financial results shall be prepared on the basis of accrual accounting policy and shall be in accordance with uniform accounting practices adopted for all the periods.

(b) The quarterly and year to date results shall be prepared in accordance with the recognition and measurement principles laid down in Accounting Standard 25 or Indian Accounting Standard 31 (AS 25/ Ind AS 34 – Interim Financial Reporting), as applicable, specified in Section 133 of the Companies Act, 2013 read with relevant rules framed there under or as specified by the Institute of Chartered Accountants of India, whichever is applicable.

(c) The standalone financial results and consolidated financial results shall be prepared as per Generally Accepted Accounting Principles in India:

Provided that in addition to the above, the listed entity may also submit the financial results, as per the International Financial Reporting Standards notified by the International Accounting Standards Board.

(d) The listed entity shall ensure that the limited review or audit reports submitted to the stock exchange(s) on a quarterly or annual basis are to be given only by an auditor who has subjected himself to the peer review process of Institute of Chartered Accountants of India and holds a valid certificate issued by the Peer Review Board of the Institute of Chartered Accountants of India.

(e) The listed entity shall make the disclosures specified in **Part A of Schedule IV.**

(2) The approval and authentication of the financial results shall be done by listed entity in the following manner:

(a) The quarterly financial results submitted shall be approved by the board of directors:

Provided that while placing the financial results before the board of directors, the chief executive officer and chief financial officer of the listed entity shall certify that the financial results do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading.

(b) The financial results submitted to the stock exchange shall be signed by the chairperson or managing director, or a whole time director or in the absence of all of them; it shall be signed by any other director of the listed entity who is duly authorized by the board of directors to sign the financial results.

(c) The limited review report shall be placed before the board of directors, at its meeting which approves the financial results, before being submitted to the stock exchange(s).

(d) The annual audited financial results shall be approved by the board of directors of the listed entity and shall be signed in the manner specified in clause (b) of sub regulation (2).

(3) The listed entity shall submit the financial results in the following manner:

(a) The listed entity shall submit quarterly and year-to-date standalone financial results to the stock exchange within forty-five days of end of each quarter, other than the last quarter

(b) In case the listed entity has subsidiaries, in addition to the requirement at clause (a) of sub-regulation (3), the listed entity 60[shall] also submit quarterly/year-to date consolidated financial results

(c) The quarterly and year-to-date financial results may be either audited or unaudited subject to the following:

(i) In case the listed entity opts to submit unaudited financial results, they shall be subject to limited review by the statutory auditors of the listed entity and shall be accompanied by the limited review report.

Provided that in case of public sector undertakings this limited review may be undertaken by any practicing Chartered Accountant.

(ii) In case the listed entity opts to submit audited financial results, they shall be accompanied by the audit report.

(d) The listed entity shall submit annual audited standalone financial results for the financial year, within sixty days from the end of the financial year along with the audit report and Statement on Impact of Audit Qualifications (applicable only for audit report with modified opinion):

Provided that if the listed entity has subsidiaries, it shall, while submitting annual audited standalone financial results also submit annual audited consolidated financial results along with the audit report and Statement on Impact of Audit Qualifications (applicable only for audit report with modified opinion)

Provided further that, in case of audit reports with unmodified opinion(s), the listed entity shall furnish a declaration to that effect to the Stock Exchange(s) while publishing the annual audited financial results.

(e) The listed entity shall also submit the audited or limited reviewed financial results in respect of the last quarter along-with the results for the entire financial year, with a note stating that the figures of last quarter are the balancing figures between audited figures in respect of the full financial year and the published year to-date figures upto the third quarter of the current financial year.

(f) The listed entity shall also submit as part of its standalone or consolidated financial results for the half year, by way of a note, a statement of assets and liabilities as at the end of the half-year.

(g) The listed entity shall also submit as part of its standalone and consolidated financial results for the half year, by way of a note, statement of cash flows for the half-year.

(h) The listed entity shall ensure that, for the purposes of quarterly consolidated financial results, at least eighty percent of each of the consolidated revenue, assets and profits, respectively, shall have been subject to audit or in case of unaudited results, subjected to limited review.

(i) The listed entity shall disclose, in the results for the last quarter in the financial year, by way of a note, the aggregate effect of material adjustments made in the results of that quarter which pertain to earlier periods.

(4) The applicable formats of the financial results and Statement on Impact of Audit Qualifications (for audit report with modified opinion) shall be in the manner as specified by the Board.

(5) For the purpose of this regulation, any reference to "quarterly/quarter" in case of listed entity which has listed their specified securities on SME Exchange shall be respectively read as "half yearly/half year" and the requirement of submitting 'year-to-date' financial results shall not be applicable for a listed entity which has listed their specified securities on SME Exchange.

(6) The Statement on Impact of Audit Qualifications (for audit report with modified opinion) and the accompanying annual audit report submitted in terms of clause (d) of sub-regulation (3) shall be reviewed by the stock exchange(s)

(7) The statutory auditor of a listed entity shall undertake a limited review of the audit of all the entities/ companies whose accounts are to be consolidated with the listed entity as per AS 21 in accordance with guidelines issued by the Board on this matter.

Annual Report

34. (1) The listed entity shall submit to the stock exchange and publish on its website-

(a) a copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders;

(b) in the event of any changes to the annual report, the revised copy along with the details of and explanation for the changes shall be sent not later than 48 hours after the annual general meeting.

(2) The annual report shall contain the following:

(a) audited financial statements i.e. balance sheets, profit and loss accounts etc and Statement on Impact of Audit Qualifications as stipulated in regulation 33(3)(d), if applicable;

(b) consolidated financial statements audited by its statutory auditors;

(c) cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3 or Indian Accounting Standard 7, as applicable, specified in Section 133 of the Companies Act, 2013 read with relevant rules framed thereunder or as specified by the Institute of Chartered Accountants of India, whichever is applicable;

(d) directors report;

(e) management discussion and analysis report - either as a part of directors report or addition thereto;

(f) for the top 78 [five hundred] listed entities based on market capitalization (calculated as on March 31 of every financial year), business responsibility report describing the initiatives taken by them from an environmental, social and governance perspective, in the format as specified by the Board from time to time:

Provided that listed entities other than top five hundred listed companies based on market capitalization and listed entities which have listed their specified securities on SME Exchange, may include these business responsibility reports on a voluntary basis in the format as specified.

(3) The annual report shall contain any other disclosures specified in Companies Act, 2013 along with other requirements as specified in Schedule V of these regulations.

Annual Information Memorandum

35. The listed entity shall submit to the stock exchange(s) an Annual Information Memorandum in the manner specified by the Board from time to time.

Documents & Information to shareholders

36. (1) The listed entity shall send the annual report in the following manner to the shareholders:

(a) Soft copies of full annual report to all those shareholder(s) who have registered their email address (es) either with the listed entity or with any depository;

(b) Hard copy of statement containing the salient features of all the documents, as prescribed in Section 136 of Companies Act, 2013 or rules made there under to those shareholder(s) who have not so registered;

(c) Hard copies of full annual reports to those shareholders, who request for the same.

(2) The listed entity shall send annual report referred to in sub-regulation (1), to the holders of securities, not less than twenty-one days before the annual general meeting.

(3) In case of the appointment of a new director or re-appointment of a director the shareholders must be provided with the following information:

(a) a brief resume of the director;

(b) nature of his expertise in specific functional areas;

(c) disclosure of relationships between directors inter-se;

(d) names of listed entities in which the person also holds the directorship and the membership of Committees of the board; and

(e) shareholding of non-executive directors.

(4) The disclosures made by the listed entity with immediate effect from date of notification of these amendments-

(a) to the stock exchanges shall be in XBRL format in accordance with the guidelines specified by the stock exchanges from time to time; and

(b) to the stock exchanges and on its website, shall be in a format that allows users to find relevant information easily through a searching tool:

Provided that the requirement to make disclosures in searchable formats shall not apply in case there is a statutory requirement to make such disclosures in formats which may not be searchable, such as copies of scanned documents.

(5) The notice being sent to shareholders for an annual general meeting, where the statutory auditor(s) is/are proposed to be appointed/re-appointed shall include the following disclosures as a part of the explanatory statement to the notice:

(a) Proposed fees payable to the statutory auditor(s) along with terms of appointment and in case of a new auditor, any material change in the fee payable to such auditor from that paid to the outgoing auditor along with the rationale for such change;

(b) Basis of recommendation for appointment including the details in relation to and credentials of the statutory auditor(s) proposed to be appointed.

Draft Scheme of Arrangement & Scheme of Arrangement

37. (1) Without prejudice to provisions of regulation 11, the listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, shall file the draft scheme of arrangement, proposed to be filed before any Court or Tribunal under sections 391-394 and 101 of the Companies Act, 1956 or under Sections 230234 and Section 66 of Companies Act, 2013, whichever applicable, along with a non-refundable fee as specified in Schedule XI, with the stock exchange(s) for obtaining Observation Letter or No-objection letter, before filing such scheme with any Court or Tribunal, in terms of requirements specified by the Board or stock exchange(s) from time to time.

(2) The listed entity shall not file any scheme of arrangement under sections 391-394 and 101 of the Companies Act, 1956 or under Sections 230-234 and Section 66 of Companies Act, 2013, whichever applicable, with any Court or Tribunal unless it has obtained observation letter or No-objection letter from the stock exchange(s).

(3) The listed entity shall place the Observation letter or No-objection letter of the stock exchange(s) before the Court or Tribunal at the time of seeking approval of the scheme of arrangement:

Provided that the validity of the 'Observation Letter' or No-objection letter of stock exchanges shall be six months from the date of issuance, within which the draft scheme of arrangement shall be submitted to the Court or Tribunal.

(4) The listed entity shall ensure compliance with the other requirements as may be prescribed by the Board from time to time.

(5) Upon sanction of the Scheme by the Court or Tribunal, the listed entity shall submit the documents, to the stock exchange(s), as prescribed by the Board and/or stock exchange(s) from time to time.

(6) Nothing contained in this regulation shall apply to draft schemes which solely provide for merger of a wholly owned subsidiary with its holding company:

Provided that such draft schemes shall be filed with the stock exchanges for the purpose of disclosures.

(7) The requirements as specified under this regulation and under regulation 94 of these regulations shall not apply to a restructuring proposal approved as part of a resolution plan by the

Tribunal under section 31 of the Insolvency Code, subject to the details being disclosed to the recognized stock exchanges within one day of the resolution plan being approved.

Minimum Public Shareholding

38. The listed entity shall comply with the minimum public shareholding requirements specified in Rule 19(2) and Rule 19A of the Securities Contracts (Regulation) Rules, 1957 in the manner as specified by the Board from time to time:

Provided that provisions of this regulation shall not apply to entities listed on institutional trading platform without making a public issue.

Issuance of Certificates or Receipts/Letters/Advices for securities and dealing with unclaimed securities

39. (1) The listed entity shall comply with Rule 19(3) of Securities Contract (Regulations) Rules, 1957 in respect of Letter/Advices of Allotment, Acceptance or Rights, transfers, subdivision, consolidation, renewal, exchanges, issuance of duplicates thereof or any other purpose.

(2) The listed entity shall issue certificates or receipts or advices, as applicable, of subdivision, split, consolidation, renewal, exchanges, endorsements, issuance of duplicates thereof or issuance of new certificates or receipts or advices, as applicable, in cases of loss or old decrepit or worn out certificates or receipts or advices, as applicable within a period of thirty days from the date of such lodgement.

(3) The listed entity shall submit information regarding loss of share certificates and issue of the duplicate certificates, to the stock exchange within two days of its getting information.

(4) The listed entity shall comply with the procedural requirements specified in Schedule VI while dealing with securities issued pursuant to the public issue or any other issue, physical or otherwise, which remain unclaimed and/or are lying in the escrow account, as applicable.

Transfer or transmission or transposition of securities

40. (1) Save as otherwise specified in provisions of securities laws or Companies Act, 2013 and rules made there under, the listed entity shall also comply with the requirements as specified in this regulation for effecting transfer of securities.

Provided that, except in case of transmission or transposition of securities, requests for effecting transfer of securities shall not be processed unless the securities are held in the dematerialized form with a depository

(2) The board of directors of a listed entity may delegate the power of transfer of securities to a committee or to compliance officer or to the registrar to an issue and/or share transfer agent(s):

Provided that the board of directors and/or the delegated authority shall attend to the formalities pertaining to transfer of securities at least once in a fortnight:

Provided further that the delegated authority shall report on transfer of securities to the board of directors in each meeting.

(3) On receipt of proper documentation, the listed entity shall register transfers of its securities in the name of the transferee(s) and issue certificates or receipts or advices, as applicable, of transfers; or issue any valid objection or intimation to the transferee or transferor, as the case may be, within a period of fifteen days from the date of such receipt of request for transfer:

Provided that the listed entity shall ensure that transmission requests are processed for securities held in dematerialized mode and physical mode within seven days and twenty one days respectively, after receipt of the specified documents:

Provided further that proper verifiable dated records of all correspondence with the investor shall be maintained by the listed entity.

(4) The listed entity shall not register transfer when any statutory prohibition or any attachment or prohibitory order of a competent authority restrains it from transferring the securities from the name of the transferor(s).

(5) The listed entity shall not register the transfer of its securities in the name of the transferee(s) when the transferor(s) objects to the transfer:

Provided that the transferor serves on the listed entity, within sixty working days of raising the objection, a prohibitory order of a Court of competent jurisdiction.

(6) The listed entity shall not decline to, register or acknowledge any transfer of shares, on the ground of the transferor(s) being either alone or jointly with any other person or persons indebted to the listed entity on any account whatsoever.

(7) The listed entity shall comply with all procedural requirements as specified in Schedule VII with respect to transfer of securities.

(8) In case the listed entity has not effected transfer of securities within fifteen days or where the listed entity has failed to communicate to the transferee(s) any valid objection to the transfer, within the stipulated time period of fifteen days, the listed entity shall compensate the aggrieved party for the opportunity losses caused during the period of the delay:

Provided that during the intervening period on account of delay in transfer above, the listed entity shall provide all benefits, which have accrued, to the holder of securities in terms of provisions of Section 126 of Companies Act, 2013, and Section 27 of the Securities Contracts (Regulation) Act, 1956:

Provided further that in case of any claim, difference or dispute under this sub-regulation the same shall be referred to and decided by arbitration as provided in the bye-laws and/or regulations of the stock exchange(s).

(9) The listed entity shall ensure that the share transfer agent and/or the in-house share transfer facility, as the case may be, produces a certificate from a practicing company secretary within one

month of the end of each half of the financial year, certifying that all certificates have been issued within thirty days of the date of lodgement for transfer, subdivision, consolidation, renewal, exchange or endorsement of calls/allotment monies.

(10) The listed entity shall ensure that certificate mentioned at sub-regulation (9), shall be filed with the stock exchange(s) simultaneously.

(11) In addition to transfer of securities, the provisions of this regulation shall also apply to the following :

(a) deletion of name of the deceased holder(s) of securities, where the securities are held in the name of two or more holders of securities ;

(b) transmission of securities to the legal heir(s), where deceased holder of securities was the sole holder of securities;

(c) transposition of securities, when there is a change in the order of names in which physical securities are held jointly in the names of two or more holders of securities.

Other provisions relating to securities

41. (1) The listed entity shall not exercise a lien on its fully paid shares and that in respect of partly paid shares it shall not exercise any lien except in respect of moneys called or payable at a fixed time in respect of such shares.

(2) The listed entity shall, in case of any amount to be paid in advance of calls on any shares stipulate that such amount may carry interest but shall not in respect thereof confer a right to dividend or to participate in profits.

(3) The listed entity shall not issue shares in any manner which may confer on any person, superior rights as to voting or dividend vis-à-vis the rights on equity shares that are already listed.

(4) The listed entity shall, issue or offer in the first instance all shares (including forfeited shares), securities, rights, privileges and benefits to subscribe pro rata basis , to the equity shareholders of the listed entity, unless the shareholders in the general meeting decide otherwise.

(5) Unless the terms of issue otherwise provide, the listed entity shall not select any of its listed securities for redemption otherwise than on pro-rata basis or by lot.

Record Date or Date of closure of transfer books

42. (1) The listed entity shall intimate the record date to all the stock exchange(s) where it is listed for the following purposes:

(a) declaration of dividend;

(b) issue of right or bonus shares

(c) issue of shares for conversion of debentures or any other convertible security;

(d) shares arising out of rights attached to debentures or any other convertible security

(e) corporate actions like mergers, de-mergers, splits and bonus shares, where stock derivatives are available on the stock of listed entity or where listed entity's stocks form part of an index on which derivatives are available;

(f) such other purposes as may be specified by the stock exchange(s).

(2) The listed entity shall give notice in advance of at least seven working days (excluding the date of intimation and the record date) to stock exchange(s) of record date specifying the purpose of the record date.

(3) The listed entity shall recommend or declare all dividend and/or cash bonuses at least five working days (excluding the date of intimation and the record date) before the record date fixed for the purpose.

(4) The listed entity shall ensure the time gap of at least thirty days between two record dates.

(5) For securities held in physical form, the listed entity may, announce dates of closure of its transfer books in place of record date for complying with requirements as specified in sub regulations (1) to (4):

Provided that the listed entity shall ensure that there is a time gap of at least thirty days between two dates of closure of its transfer books.

Dividends

43. (1) The listed entity shall declare and disclose the dividend on per share basis only.

(2) The listed entity shall not forfeit unclaimed dividends before the claim becomes barred by law and such forfeiture, if effected, shall be annulled in appropriate cases.

Dividend Distribution Policy

43A. (1) The top five hundred listed entities based on market capitalization (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy which shall be disclosed in their annual reports and on their websites.

(2) The dividend distribution policy shall include the following parameters:

(a) the circumstances under which the shareholders of the listed entities may or may not expect dividend;

(b) the financial parameters that shall be considered while declaring dividend;

(c) internal and external factors that shall be considered for declaration of dividend;

(d) policy as to how the retained earnings shall be utilized; and

(e) parameters that shall be adopted with regard to various classes of shares:

Provided that if the listed entity proposes to declare dividend on the basis of parameters in addition to clauses (a) to (e) or proposes to change such additional parameters or the dividend distribution policy contained in any of the parameters, it shall disclose such changes along with the rationale for the same in its annual report and on its website.

(3) The listed entities other than top five hundred listed entities based on market capitalization may disclose their dividend distribution policies on a voluntary basis in their annual reports and on their websites.

Meetings of shareholders and voting

44. (1) The listed entity shall provide the facility of remote e-voting facility to its shareholders, in respect of all shareholders' resolutions.

(2) The e-voting facility to be provided to shareholders in terms of sub-regulation (1), shall be provided in compliance with the conditions specified under the Companies (Management and Administration) Rules, 2014, or amendments made thereto.

(3) The listed entity shall submit to the stock exchange, within forty eight hours of conclusion of its General Meeting, details regarding the voting results in the format specified by the Board.

(4) The listed entity shall send proxy forms to holders of securities in all cases mentioning that a holder may vote either for or against each resolution.

(5) The top 100 listed entities by market capitalization, determined as on March 31st of every financial year, shall hold their annual general meetings within a period of five months from the date of closing of the financial year.

(6) The top 100 listed entities shall provide one-way live webcast of the proceedings of the annual general meetings. Explanation: The top 100 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

Change in name of the listed entity

45. (1) The listed entity shall be allowed to change its name subject to compliance with the following conditions:

(a) a time period of at least one year has elapsed from the last name change;

(b) at least fifty percent. of the total revenue in the preceding one year period has been accounted or by the new activity suggested by the new name; or

(c) the amount invested in the new activity/project is at least fifty percent. of the assets of the listed entity:

Provided that if any listed entity has changed its activities which are not reflected in its name, it shall change its name in line with its activities within a period of six months from the change of activities in compliance of provisions as applicable to change of name prescribed under Companies Act, 2013.

Explanation: For the purpose of this regulation, -

(i) 'assets' of the listed entity means the sum of fixed assets, advances, works in Progress / Inventories, investments, trade receivables, cash & cash equivalents;

(ii) 'advances' shall include only those amounts extended to contractors and suppliers towards execution of project, specific to new activity as reflected in the new name.

(2) On satisfaction of conditions at sub-regulation (1), the listed entity shall file an application for name availability with Registrar of Companies.

(3) On receipt of confirmation regarding name availability from Registrar of Companies, before filing the request for change of name with the Registrar of Companies in terms of provisions laid down in Companies Act, 2013 and rules made there under, the listed entity shall seek approval from Stock Exchange by submitting a certificate from chartered accountant stating compliance with conditions at sub-regulation (1).

Website

46. (1) The listed entity shall maintain a functional website containing the basic information about the listed entity.

(2) The listed entity shall disseminate the following information 91[under a separate section on its website:

(a) details of its business;

(b) terms and conditions of appointment of independent directors;

(c) composition of various committees of board of directors;

(d) code of conduct of board of directors and senior management personnel;

(e) details of establishment of vigil mechanism/ Whistle Blower policy;

(f) criteria of making payments to non-executive directors, if the same has not been disclosed in annual report;

(g) policy on dealing with related party transactions;

(h) policy for determining 'material' subsidiaries;

(i) details of familiarization programmes imparted to independent directors including the following details:-

(i) number of programmes attended by independent directors (during the year and on a cumulative basis till date),

(ii) number of hours spent by independent directors in such programmes (during the year and on cumulative basis till date), and

(iii) other relevant details

(j) the email address for grievance redressal and other relevant details;

(k) contact information of the designated officials of the listed entity who are responsible for assisting and handling investor grievances;

(l) financial information including:

(i) notice of meeting of the board of directors where financial results shall be discussed;

(ii) financial results, on conclusion of the meeting of the board of directors where the financial results were approved;

(iii) complete copy of the annual report including balance sheet, profit and loss account, directors report, corporate governance report etc;

(m) shareholding pattern;

(n) details of agreements entered into with the media companies and/or their associates, etc;

(o) schedule of analyst or institutional investor meet and presentations made by the listed entity to analysts or institutional investors simultaneously with submission to stock exchange;

(p) new name and the old name of the listed entity for a continuous period of one year, from the date of the last name change;

(q) items in sub-regulation (1) of regulation 47.

(r) With effect from October 1, 2018, all credit ratings obtained by the entity for all its outstanding instruments, updated immediately as and when there is any revision in any of the ratings.

(s) separate audited financial statements of each subsidiary of the listed entity in respect of a relevant financial year, uploaded at least 21 days prior to the date of the annual general meeting which has been called to inter alia consider accounts of that financial year.

(3) (a) The listed entity shall ensure that the contents of the website are correct.

(b) The listed entity shall update any change in the content of its website within two working days from the date of such change in content.

Advertisements in Newspapers

47. (1) The listed entity shall publish the following information in the newspaper:

(a) notice of meeting of the board of directors where financial results shall be discussed

(b) financial results, as specified in regulation 33, along-with the modified opinion(s) or reservation(s), if any, expressed by the auditor:

Provided that if the listed entity has submitted both standalone and consolidated financial results, the listed entity shall publish consolidated financial results along with (1) Turnover, (2) Profit before tax and (3) Profit after tax, on a stand-alone basis, as a foot note; and a reference to the places, such as the website of listed entity and stock exchange(s), where the standalone results of the listed entity are available.

(c) statements of deviation(s) or variation(s) as specified in sub-regulation (1) of regulation 32 on quarterly basis, after review by audit committee and its explanation in directors report in annual report; (d) notices given to shareholders by advertisement.

(2) The listed entity shall give a reference in the newspaper publication, in sub-regulation (1), to link of the website of listed entity and stock exchange(s), where further details are available.

(3) The listed entity shall publish the information specified in sub-regulation (1) in the newspaper simultaneously with the submission of the same to the stock exchange(s).

Provided that financial results at clause (b) of sub-regulation (1), shall be published within 48 hours of conclusion of the meeting of board of directors at which the financial results were approved.

(4) The information at sub-regulation (1) shall be published in at least one English language national daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the listed entity is situated:

Provided that the requirements of this regulation shall not be applicable in case of listed entities which have listed their specified securities on SME Exchange.

Accounting Standards

48. The listed entity shall comply with all the applicable and notified Accounting Standards from time to time.

CHAPTER V

OBLIGATIONS OF LISTED ENTITY WHICH HAS LISTED ITS NON-CONVERTIBLE DEBT SECURITIES OR NON-CONVERTIBLE REDEEMABLE PREFERENCE SHARES OR BOTH

Applicability

49. (1) The provisions of this chapter shall apply only to a listed entity which has listed its 'Non-convertible Debt Securities' and/or 'Non-Convertible Redeemable Preference Shares' on a recognised stock exchange in accordance with Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008 or Securities and Exchange Board of India (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 respectively.

(2) The provisions of this chapter shall also be applicable to "perpetual debt instrument" and "perpetual non-cumulative preference share" listed by banks.

Explanation (1) - For the purpose of this chapter, "Bank" means any bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

Explanation (2) - For the purpose of this chapter, if the listed entity has listed its nonconvertible redeemable preference shares:

(i) The reference to "interest" may also read as dividend;

(ii) The provisions concerning debenture trustees and security creation (or asset cover or charge on assets) shall not be applicable for "non-convertible redeemable preference shares"

Intimation to stock exchange(s)

50. (1) The listed entity shall give prior intimation to the stock exchange(s) at least eleven working days before the date on and from which the interest on debentures and bonds, and redemption amount of redeemable shares or of debentures and bonds shall be payable.

(2) The listed entity shall intimate the stock exchange(s), its intention to raise funds through new non-convertible debt securities or non-convertible redeemable preference shares it proposes to list either through a public issue or on private placement basis, prior to issuance of such securities:

Provided that the above intimation may be given prior to the meeting of board of directors wherein the proposal to raise funds through new non-convertible debt securities or nonconvertible redeemable preference shares shall be considered.

(3) The listed entity shall intimate to the stock exchange(s), at least two working days in advance, excluding the date of the intimation and date of the meeting, regarding the meeting of its board of directors, at which the recommendation or declaration of issue of non-convertible debt securities or

any other matter affecting the rights or interests of holders of non-convertible debt securities or non-convertible redeemable preference shares is proposed to be considered.

Disclosure of information having bearing on performance/operation of listed entity and/or price sensitive information

51. (1) The listed entity shall promptly inform the stock exchange(s) of all information having bearing on the performance/operation of the listed entity, price sensitive information or any action that shall affect payment of interest or dividend of nonconvertible preference shares or redemption of non convertible debt securities or redeemable preference shares.

Explanation - The expression 'promptly inform', shall imply that the stock exchange must be informed as soon as practically possible and without any delay and that the information shall be given first to the stock exchange(s) before providing the same to any third party.

(2) Without prejudice to the generality of sub-regulation (1), the listed entity who has issued or is issuing non-convertible debt securities and/or non-convertible redeemable preference shares shall make disclosures as specified in Part B of Schedule III.

Financial Results

52. (1) The listed entity shall prepare and submit un-audited or audited financial results on a half yearly basis in the format as specified by the Board within forty five days from the end of the half year to the recognised stock exchange(s).

Provided that in case of entities which have listed their equity shares and debt securities, a copy of the financial results submitted to stock exchanges shall be provided to Debenture Trustees on the same day the information is submitted to stock exchanges.

(2) The listed entity shall comply with following requirements with respect to preparation, approval, authentication and publication of annual and half-yearly financial results:

(a) Un-audited financial results shall be accompanied by limited review report prepared by the statutory auditors of the listed entity or in case of public sector undertakings, by any practicing Chartered Accountant, in the format as specified by the Board:

Provided that if the listed entity intimates in advance to the stock exchange(s) that it shall submit to the stock exchange(s) its annual audited results within sixty days from the end of the financial year, un-audited financial results for the last half year accompanied by limited review report by the auditors need not be submitted to stock exchange(s).

(b) Half-yearly results shall be taken on record by the board of directors and signed by the managing director / executive director.

(c) The audited results for the year shall be submitted to the recognised stock exchange(s) in the same format as is applicable for half-yearly financial results.

(d) If the listed entity opts to submit un-audited financial results for the last half year accompanied by limited review report by the auditors, it shall also submit audited financial results for the entire financial year, as soon as they are approved by the board of directors.

(e) Modified opinion(s) in audit reports that have a bearing on the interest payment/ dividend payment pertaining to non-convertible redeemable debentures/ redemption or principal repayment capacity of the listed entity shall be appropriately and adequately addressed by the board of directors while publishing the accounts for the said period.

(3) (a) The annual audited financial results shall be submitted along with the annual audit report and Statement on Impact of Audit Qualifications (applicable only] for audit report with modified opinion

Provided that, in case of audit reports with unmodified opinion, the listed entity shall furnish a declaration to that effect to the Stock Exchange(s) while publishing the annual audited financial results.

(b) The Statement on Impact of Audit Qualifications for audit report with modified opinion and the accompanying annual audit report submitted in terms of clause (a) shall be reviewed by the stock exchange(s)

(c) The applicable format of Statement on Impact of Audit Qualifications (for audit report with modified opinion) shall be in the manner as specified by the Board.

(4) The listed entity, while submitting half yearly / annual financial results, shall disclose the following line items along with the financial results:

(a) credit rating and change in credit rating (if any);

(b) asset cover available, in case of non-convertible debt securities;

(c) debt-equity ratio;

(d) previous due date for the payment of interest/ dividend for non-convertible redeemable preference shares/ repayment of principal of non-convertible preference shares /non convertible debt securities and whether the same has been paid or not; and,

(e) next due date for the payment of interest/ dividend of non-convertible preference shares /principal along with the amount of interest/ dividend of non-convertible preference shares payable and the redemption amount;

(f) debt service coverage ratio;

(g) interest service coverage ratio;

(h) outstanding redeemable preference shares (quantity and value);

(i) capital redemption reserve/debenture redemption reserve;

(j) net worth;

(k) net profit after tax;

(l) earnings per share:

Provided that the requirement of disclosures of debt service coverage ratio, asset cover and interest service coverage ratio shall not be applicable for banks or non-banking financial companies registered with the Reserve Bank of India.

Provided further that the requirement of this sub- regulation shall not be applicable in case of unsecured debt instruments issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators.

(5) The listed entity shall, within seven working days from the date of submission of the information required under sub- regulation (4), submit to stock exchange(s), a certificate signed by debenture trustee that it has taken note of the contents.

(6) The listed entity which has listed its non-convertible redeemable preference shares shall make the following additional disclosures as notes to financials:

(a) profit for the half year and cumulative profit for the year;

(b) free reserve as on the end of half year;

(c) securities premium account balance (if redemption of redeemable preference share is to be done at a premium, such premium may be appropriated from securities premium account):

Provided that disclosure on securities premium account balance may be provided only in the year in which non convertible redeemable preference shares are due for redemption;

(d) track record of dividend payment on non convertible redeemable preference shares:

Provided that in case the dividend has been deferred at any time, then the actual date of payment shall be disclosed;

(e) breach of any covenants under the terms of the non convertible redeemable preference shares:

Provided that in case a listed entity is planning a fresh issuance of shares whose end use is servicing of the non convertible redeemable preference shares (whether dividend or principle redemption), then the same shall be disclosed whenever the listed entity decided on such issuances.

(7) The listed entity shall submit to the stock exchange on a half yearly basis along with the half yearly financial results, a statement indicating material deviations, if any, in the use of proceeds of issue of non convertible debt securities and non-convertible redeemable preference shares from the objects stated in the offer document.

(8) The listed entity shall, within two calendar days of the conclusion of the meeting of the board of directors, publish the financial results and statement referred to in sub-regulation (4), in at least one English national daily newspaper circulating in the whole or substantially the whole of India.

Annual Report

53. The annual report of the listed entity shall contain disclosures as specified in Companies Act, 2013 along with the following:

(a) audited financial statements i.e. balance sheets, profit and loss accounts etc. and Statement on Impact of Audit Qualifications as stipulated in regulation 52(3)(a), if applicable;

(b) cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3/ Indian Accounting Standard 7, mandated under Section 133 of the Companies Act, 2013 read with relevant rules framed there under or by the Institute of Chartered Accountants of India, whichever is applicable;

(c) auditors report;

(d) directors report;

(e) name of the debenture trustees with full contact details ;

(f) related party disclosures as specified in Para A of Schedule V.

Asset Cover

54. (1) In respect of its listed non-convertible debt securities, the listed entity shall maintain hundred per cent. asset cover sufficient to discharge the principal amount at all times for the non-convertible debt securities issued.

(2) The listed entity shall disclose to the stock exchange in quarterly, half-yearly, year to-date and annual financial statements, as applicable, the extent and nature of security created and maintained with respect to its secured listed non-convertible debt securities.

(3) The requirement specified in sub-regulation (1), shall not be applicable in case of unsecured debt securities issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators.

Credit Rating

55. Each rating obtained by the listed entity with respect to non-convertible debt securities shall be reviewed at least once a year by a credit rating agency registered by the Board.

Documents and Intimation to Debenture Trustees

56. (1) The listed entity shall forward the following to the debenture trustee promptly:

(a) a copy of the annual report at the same time as it is issued along with a copy of certificate from the listed entity's auditors in respect of utilisation of funds during the implementation period of the project for which the funds have been raised:

Provided that in the case of debentures or preference shares issued for financing working capital or general corporate purposes or for capital raising purposes the copy of the auditor's certificate may be submitted at the end of each financial year till the funds have been fully utilised or the purpose for which these funds were intended has been achieved.

(b) a copy of all notices, resolutions and circulars relating to-

(i) new issue of non-convertible debt securities at the same time as they are sent to shareholders/ holders of non-convertible debt securities;

(ii) the meetings of holders of non-convertible debt securities at the same time as they are sent to the holders of non-convertible debt securities or advertised in the media including those relating to proceedings of the meetings;

(c) intimations regarding :

(i) any revision in the rating;

(ii) any default in timely payment of interest or redemption or both in respect of the non-convertible debt securities;

(iii) failure to create charge on the assets;

(d) a half-yearly certificate regarding maintenance of hundred percent. asset cover in respect of listed non-convertible debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half yearly financial results:

Provided that submission of such half yearly certificates is not applicable in cases where a listed entity is a bank or non banking financial companies registered with Reserve Bank of India or where bonds are secured by a Government guarantee.

(2) The listed entity shall forward to the debenture trustee any such information sought and provide access to relevant books of accounts as required by the debenture trustee.

(3) The listed entity may, subject to the consent of the debenture trustee, send the information stipulated in sub-regulation (1), in electronic form/fax.

Other submissions to stock exchange(s)

57. (1) The listed entity shall submit a certificate to the stock exchange within two days of the interest or principal or both becoming due that it has made timely payment of interests or principal obligations or both in respect of the non-convertible debt securities.

(2) The listed entity shall provide an undertaking to the stock exchange(s) on annual basis stating that all documents and intimations required to be submitted to Debenture Trustees in terms of

Trust Deed and Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008 have been complied with.

(3) The listed entity shall forward to the stock exchange any other information in the manner and format as specified by the Board from time to time.

Documents and information to holders of non-convertible debt securities and non-convertible preference shares

58. (1) The listed entity shall send the following documents:

(a) Soft copies of full annual reports to all the holders of non-convertible preference share who have registered their email address(es) for the purpose;

(b) Hard copy of statement containing the salient features of all the documents, as specified in Section 136 of Companies Act, 2013 and rules made there under to those holders of non-convertible preference share who have not so registered;

(c) Hard copies of full annual reports to those holders of non-convertible debt securities and non-convertible preference share, who request for the same.

(d) Half yearly communication as specified in sub-regulation (4) and (5) of regulation 52, to holders of non-convertible debt securities and non-convertible preference shares;

(2) The listed entity shall send the notice of all meetings of holders of non-convertible debt securities and holders of non-convertible redeemable preference shares specifically stating that the provisions for appointment of proxy as mentioned in Section 105 of the Companies Act, 2013, shall be applicable for such meeting.

(3) The listed entity shall send proxy forms to holders of non-convertible debt securities and non-convertible redeemable preference shares which shall be worded in such a manner that holders of these securities may vote either for or against each resolution.

Structure of non-convertible debt securities and non-convertible redeemable preference shares

59. (1) The listed entity shall not make material modification without prior approval of the stock exchange(s) where the non-convertible debt securities or non-convertible redeemable preference shares, as applicable, are listed, to:

(a) the structure of the debenture in terms of coupon, conversion, redemption, or otherwise.

(b) the structure of the non-convertible redeemable preference shares in terms of dividend of non-convertible preference shares payable, conversion, redemption, or otherwise.

(2) The approval of the stock exchange referred to in sub-regulation (1) shall be made only after:

(a) approval of the board of directors and the debenture trustee in case of nonconvertible debt securities and

(b) after complying with the provisions of Companies Act, 2013 including approval of the consent of requisite majority of holders of that class of securities.

Record Date

60. (1) The listed entity shall fix a record date for purposes of payment of interest, dividend and payment of redemption or repayment amount or for such other purposes as specified by the stock exchange.

(2) The listed entity shall give notice in advance of at least seven working days (excluding the date of intimation and the record date) to the recognised stock exchange(s) of the record date or of as many days as the stock exchange(s) may agree to or require specifying the purpose of the record date.

Terms of non-convertible debt securities and non-convertible redeemable preference shares

61. (1) The listed entity shall ensure timely payment of interest or dividend of nonconvertible redeemable preference shares or redemption payment:

Provided that the listed entity shall not declare or distribute any dividend wherein it has defaulted in payment of interest on debt securities or redemption thereof or in creation of security as per the terms of the issue of debt securities:

Provided further that this requirement shall not be applicable in case of unsecured debt securities issued by regulated financial sector entities eligible for meeting capital requirements as specified by respective regulators.

(2) The listed entity shall not forfeit unclaimed interest/dividend and such unclaimed interest/dividend shall be transferred to the 'Investor Education and Protection Fund' set up as per Section 125 of the Companies Act, 2013.

(3) Unless the terms of issue provide otherwise, the listed entity shall not select any of its listed securities for redemption otherwise than pro rata basis or by lot.

(4) The listed entity shall comply with requirements as specified in regulation 40 for transfer of securities including procedural requirements specified in Schedule VII.

Website

62. (1) The listed entity shall maintain a functional website containing the following information about the listed entity:-

(a) details of its business;

(b) financial information including complete copy of the annual report including balance sheet, profit and loss account, directors report etc;

(c) contact information of the designated officials of the listed entity who are responsible for assisting and handling investor grievances;

(d) email address for grievance redressal and other relevant details;

(e) name of the debenture trustees with full contact details;

(f) the information, report, notices, call letters, circulars, proceedings, etc concerning non-convertible redeemable preference shares or nonconvertible debt securities;

(g) all information and reports including compliance reports filed by the listed entity;

(h) information with respect to the following events:

(i) default by issuer to pay interest on or redemption amount;

(ii) failure to create a charge on the assets;

(iii) revision of rating assigned to the non-convertible debt securities:

(2) The listed entity may also issue a press release with respect to the events specified in sub regulation (1).

(3) The listed entity shall ensure that the contents of the website are correct and updated at any given point of time.

CHAPTER VI

OBLIGATIONS OF LISTED ENTITY WHICH HAS LISTED ITS SPECIFIED SECURITIES AND EITHER NON-CONVERTIBLE DEBT SECURITIES OR NON-CONVERTBLE REDEEMABLE PREFERENCE SHARES OR BOTH

Applicability of Chapters IV and V

63. (1) Entity which has listed its 'specified securities' and 'non-convertible debt securities' or 'non-convertible redeemable preference shares' or both on any recognised stock exchange, shall be bound by the provisions in Chapter IV of these regulations.

(2) The listed entity described in sub-regulation (1) shall additionally comply with the following regulations in Chapter V:

(a) regulation 50(2),(3);

(b) regulation 51;

(c) regulation 52(3), (4), (5) and (6);

(d) regulation 53

(e) regulation 54

(f) regulation 55

(g) regulation 56

(h) regulation 57

(i) regulation 58

(j) regulation 59

(k) regulation 60

(l) regulation 61:

Provided that the listed entity which has submitted any information to the stock exchange in compliance with the disclosure requirements under Chapter IV of these regulations, need not re-submit any such information under the provisions of this regulations without prejudice to any power conferred on the Board or the stock exchange or any other authority under any law to seek any such information from the listed entity:

Provided further that the listed entity, which has satisfied certain obligations in compliance with other chapters, shall not separately satisfy the same conditions under this chapter.

Delisting

64. (1) In the event specified securities of the listed entity are delisted from the stock exchange, the listed entity shall comply with all the provisions in Chapter V of these regulations.

(2) In the event that non-convertible debt securities and non-convertible redeemable preference shares' of the listed entity do not remain listed on the stock exchange, the listed entity shall comply with all the provisions in Chapter IV of these regulations.

CHAPTER VII

OBLIGATIONS OF LISTED ENTITY WHICH HAS LISTED ITS INDIAN DEPOSITORY RECEIPTS

Applicability

65. The provisions of this chapter shall apply to listed entity whose securities market regulators are signatories to the Multilateral Memorandum of Understanding of International Organization of Securities Commission issuing 'Indian Depository Receipts' as defined under Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014.

Definitions

66. For the purpose of this chapter, unless the context otherwise requires -

(a) "IDR Holder(s)" shall mean holder(s) of Indian Depository Receipts.

(b) "Depository Agreement" shall mean an agreement between the listed entity and the domestic depository

(c) "Home Country" or "country of origin" shall mean the country or parent country where the listed entity is incorporated and listed.

(d) "Security holder" shall mean holder of the security or equity shares of the listed entity in the home country.

General Obligations of listed entity

67. (1) All correspondences filed with the stock exchange(s) and those sent to the IDR Holders shall be in English.

(2) The listed entity shall comply, at all times, with the rules/regulations/laws of the country of origin.

(3) The listed entity shall undertake that the competent Courts, Tribunals and regulatory authorities in India shall have jurisdiction in the event of any dispute, either with the stock exchange or any investor, concerning the India Depository Receipts offered or subscribed or bought in India.

(4) The listed entity shall forward, on a continuous basis, any information requested by the stock exchange, in the interest of investors from time to time.

(5) In case of any claim, difference or dispute under the provisions of this chapter and other provisions of these regulations applicable to the listed entity, the same shall be referred to and decided by arbitration as provided in the bye-laws and regulations of the stock exchange(s).

Disclosure of material events or information

68. (1) The listed entity shall promptly inform to the stock exchange(s) of all events which are material, all information which is price sensitive and/or have bearing on performance/operation of the listed entity.

(2) Without prejudice to the generality of sub-regulation (1), the listed entity shall make the disclosures as specified in Part C of Schedule III.

Indian Depository Receipt holding pattern & Shareholding details

69. (1) The listed entity shall file with the stock exchange the Indian Depository Receipt holding pattern on a quarterly basis within fifteen days of end of the quarter in the format specified by the Board.

(2) The listed entity shall file the following details with the stock exchange as is required to be filed in compliance with the disclosure requirements of the listing authority or stock exchange in its home country or any other jurisdiction where the securities of the listed entity are listed:

(a) Shareholding Pattern;

(b) Pre and post arrangement share holding pattern and Capital Structure in case of any corporate restructuring like mergers / amalgamations

Periodical Financial Results

70. (1) The listed entity shall file periodical financial results with the stock exchange in such manner and within such time and to the extent that it is required to file as per the listing requirements of the home country.

(2) The listed entity shall comply with the requirements with respect to preparation and disclosures in financial results as specified in Part B of Schedule IV.

Annual Report

71. (1) The listed entity shall submit to stock exchange an annual report at the same time as it is disclosed to the security holder in its home country or in other jurisdictions where such securities are listed.

(2) The annual report shall contain the following:

(a) Report of board of directors;

(b) Balance Sheet;

(c) Profit and Loss Account;

(d) Auditors Report;

(e) All periodical and special reports (if applicable);

(f) Any such other report which is required to be sent to security holders annually.

(3) The listed entity shall comply with the requirements with respect to preparation and disclosures in financial results in annual report as specified in Part B of Schedule IV.

Corporate Governance

72. (1) The listed entity shall comply with the corporate governance provisions as applicable in its home country and other jurisdictions in which its equity shares are listed.

(2) The listed entity shall submit to stock exchange a comparative analysis of the corporate governance provisions that are applicable in its home country and in the other jurisdictions in which its equity shares are listed along with the compliance of the same vis-à-vis the corporate governance requirements applicable under regulation 17 to regulation 27, to other listed entities.

Documents and Information to IDR Holder

73. The listed entity shall disclose/send the following documents to IDR Holders, at the same time and to the extent that it discloses to security holders in its home country or in other jurisdictions where its securities are listed:

(a) Soft copies of the annual report to all the IDR holders who have registered their email address(es) for the purpose

(b) Hard copy of the annual report to those IDR holders who request for the same either through domestic depository or Compliance Officer

(c) the pre and post arrangement capital structure and share holding pattern in case of any corporate restructuring like mergers / amalgamations and other schemes

Equitable Treatment to IDR Holders

74. (1) If the listed entity's equity shares or other securities representing equity shares are also listed on the stock exchange(s) in countries other than its home country, it shall ensure that IDR Holders are treated in a manner equitable with security holders in home country.

(2) The listed entity shall ensure that for all corporate actions, except those which are not permitted by Indian laws, it shall treat IDR holders in a manner equitable with security holders in the home country.

(3) In case of take-over or delisting or buy-back of its equity shares, the listed entity shall, while following the laws applicable in its home country, give equitable treatment to IDR holders vis-à-vis security holder in home country.

(4) The listed entity shall ensure protection of interests of IDR holders particularly with respect to all corporate benefits permissible under Indian laws and the laws of its home country and shall address all investor grievances adequately.

Advertisements in Newspapers

75. (1) The listed entity shall publish the following information in the newspaper :

(a) periodical financial results required to be disclosed;

(b) Notices given to its IDR Holders by advertisement;

(2) The information specified in sub-regulation (1) shall be issued in at one English national daily newspaper circulating in the whole or substantially the whole of India and in one Hindi national daily newspaper in India.

Terms of Indian Depository Receipts

76. (1) The listed entity shall pay the dividend as per the timeframe applicable in its home country or other jurisdictions where its securities are listed, whichever is earlier, so as to reach the IDR Holders on or before the date fixed for payment of dividend to holders of its equity share or other securities.

(2) The listed entity shall not forfeit unclaimed dividends before the claim becomes barred by law in the home country of the listed entity, as may be applicable, and that such forfeiture, when effected, shall be annulled in appropriate cases.

(3) The Indian Depository Receipts shall have two-way fungibility in the manner specified by the Board from time to time.

Structure of Indian Depository Receipts

77. (1) The listed entity shall ensure that the underlying shares of IDRs shall rank pari-passu with the existing shares of the same class and the fact of having different classes of shares based on different criteria, if any, shall be disclosed by the listed entity in the annual report.

(2) The listed entity shall not exercise a lien on the fully paid underlying shares, against which the IDRs are issued, and that in respect of partly paid underlying shares, against which the IDRs are issued and shall also not exercise any lien except in respect of moneys called or payable at a fixed time in respect of such underlying shares.

(3) The listed entity, subject to the requirements under the laws and regulations of its home country, if any amount be paid up in advance of calls on any underlying shares against which the IDRs are issued, shall stipulate that such amount may carry interest but shall not in respect thereof confer a right to dividend or to participate in profits.

Record Date

78. (1) The listed entity, where it is required so to do in its home country or other jurisdictions where its securities may be listed, shall fix the record date for the purpose of payment of dividends or distribution of any other corporate benefits to IDR Holders.

(2) The listed entity shall give notice in advance of at least four working days to the recognised stock exchange(s) of record date specifying the purpose of the record date.

Voting

79. (1) The listed entity shall, either directly or through an agent, send out proxy forms to IDR Holders in all cases mentioning that a security holder may vote either for or against each resolution.

(2) Voting rights of the IDR Holders shall be exercised in accordance with the depository agreement.

Delisting of Indian Depository Receipt

80. (1) The listed entity shall, if it decides to delist Indian Depository Receipts, give fair and reasonable treatment to IDR holders.

(2) The listed entity shall comply with such norms and conditions for delisting Indian Depository Receipts as specified by the Board or stock exchange in this regard.

(3) The listed entity shall, in case underlying equity shares are delisted, shall delist and cancel the Indian Depository Receipts.

CHAPTER VIII

OBLIGATIONS OF LISTED ENTITY WHICH HAS LISTED ITS SECURITISED DEBT INSTRUMENTS

Applicability

81. (1) The provisions of this chapter shall apply to Special Purpose Distinct Entity issuing securitised debt instruments and trustees of Special Purpose Distinct Entity shall ensure compliance with each of the provisions of these regulations.

(2) The expressions "asset pool", "clean up call option", "credit enhancement", "debt or receivables", "investor", "liquidity provider", "obligor", "originator", "regulated activity", "scheme", "securitization", "securitized debt instrument", "servicer", "special purpose distinct entity", "sponsor" and "trustee" shall have the same meaning as assigned to them under Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008;

Intimation and filings with stock exchange(s)

82. (1) The listed entity shall intimate the Stock exchange, of its intention to issue new securitized debt instruments either through a public issue or on private placement basis (if it proposes to list such privately placed debt securities on the Stock exchange) prior to issuing such securities.

(2) The listed entity shall intimate to the stock exchange(s), at least two working days in advance, excluding the date of the intimation and date of the meeting, regarding the meeting of its board of trustees, at which the recommendation or declaration of issue of securitized debt instruments or any other matter affecting the rights or interests of holders of securitized debt instruments is proposed to be considered.

(3) The listed entity shall submit such statements, reports or information including financial information pertaining to Schemes to stock exchange within seven days from the end of the month/ actual payment date, either by itself or through the servicer, on a monthly basis in the format as specified by the Board from time to time:

Provided that where periodicity of the receivables is not monthly, reporting shall be made for the relevant periods.

(4) The listed entity shall provide the stock exchange, either by itself or through the servicer, loan level information, without disclosing particulars of individual borrowers, in manner specified by stock exchange.

Disclosure of information having bearing on performance/operation of listed entity and/or price sensitive information

83. (1) The listed entity shall promptly inform the stock exchange(s) of all information having bearing on the on performance/operation of the listed entity and price sensitive information.

(2) Without prejudice to the generality of sub-regulation(1), the listed entity shall make the disclosures specified in Part D of Schedule III.

Explanation. - The expression 'promptly inform', shall imply that the stock exchange must be informed must as soon as practically possible and without any delay and that the information shall be given first to the stock exchange(s) before providing the same to any third party.

Credit Rating

84. (1) Every rating obtained by the listed entity with respect to securitised debt instruments shall be periodically reviewed, preferably once a year, by a credit rating agency registered by the Board.

(2) Any revision in rating(s) shall be disseminated by the stock exchange(s).

Information to Investors

85. (1) The listed entity shall provide either by itself or through the servicer, loan level information without disclosing particulars of individual borrower to its investors.

(2) The listed entity shall provide information regarding revision in rating as a result of credit rating done periodically in terms of regulation 84 above to its investors.

(3) The information at sub-regulation (1) and (2) may be sent to investors in electronic form/fax if so consented by the investors.

(4) The listed entity shall display the email address of the grievance redressal division and other relevant details prominently on its website and in the various materials / pamphlets/ advertisement campaigns initiated by it for creating investor awareness.

Terms of Securitized Debt Instruments

86. (1) The listed entity shall ensure that no material modification shall be made to the structure of the securitized debt instruments in terms of coupon, conversion, redemption, or otherwise without prior approval of the recognised stock exchange(s) where the securitized debt instruments are listed and the listed entity shall make an application to the recognised stock exchange(s) only after the approval by Trustees.

(2) The listed entity shall ensure timely interest/ redemption payment.

(3) The listed entity shall ensure that where credit enhancement has been provided for, it shall make credit enhancement available for listed securitized debt instruments at all times.

(4) The listed entity shall not forfeit unclaimed interest and principal and such unclaimed interest and principal shall be, after a period of seven years, transferred to the Investor Protection and

Education Fund established under the Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009.

(5) Unless the terms of issue provide otherwise, the listed entity shall not select any of its listed securitized debt instruments for redemption otherwise than on pro rata basis or by lot and shall promptly submit to the recognised stock exchange(s) the details thereof.

(6) The listed entity shall remain listed till the maturity or redemption of securitised debt instruments or till the same are delisted as per the procedure laid down by the Board

Provided that the provisions of this sub-regulation shall not restrict the right of the recognised stock exchange(s) to delist, suspend or remove the securities at any time and for any reason which the recognised stock exchange(s) considers proper in accordance with the applicable legal provisions.

Record Date

87. (1) The listed entity shall fix a record date for payment of interest and payment of redemption or repayment amount or for such other purposes as specified by the recognised stock exchange(s).

(2) The listed entity shall give notice in advance of atleast seven working days (excluding the date of intimation and the record date) to the recognised stock exchange(s) of the record date or of as many days as the Stock Exchange may agree to or require specifying the purpose of the record date.

CHAPTER VIII A

OBLIGATIONS OF LISTED ENTITY WHICH HAS LISTED ITS SECURITY RECEIPTS

Applicability

87A. (1) The provisions of this chapter shall apply to the issuer of security receipts which has listed its security receipts and the issuer and its sponsor shall ensure compliance with each of the provisions of these Regulations.

(2) The expressions “asset reconstruction company”, "investor", “issue”, “issuer”, “offer for sale”, “private placement offer”, “qualified buyer”, "scheme", “security receipts”, "sponsor", and “valuer” shall have the same meaning as assigned to them under Securities and Exchange Board of India (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008.

Intimations and Disclosure of events or information to Stock Exchanges

87B. (1) The listed entity shall first disclose to stock exchange(s) of all events or information, as specified in Part E of Schedule III, as soon as reasonably possible but not later than twenty four hours from occurrence of the event or information:

Provided that in case the disclosure is made after twenty four hours of occurrence of the event or information, the listed entity shall, along with such disclosures provide explanation for the delay.

(2) The listed entity with respect to disclosures referred to in this regulation, shall provide updates related to such disclosures on a regular basis, till such time the event is resolved/closed, with relevant explanations.

(3) The listed entity shall provide specific and adequate reply to all queries raised by stock exchange(s) with respect to any events or information.

Provided that the stock exchange(s) shall disseminate information and clarification as soon as reasonably practicable.

(4) The listed entity, suo moto, may confirm or deny any reported event or information to stock exchange(s).

(5) The listed entity shall disclose on its website or on the website of the sponsor all such events or information which has been disclosed to stock exchange(s) under this regulation, and such disclosures shall be hosted on the website of the listed entity for a minimum period of five years and thereafter as per the archival policy of the listed entity, as disclosed on its website.

Valuation, Rating and NAV disclosure

87C. (1) An issuer whose security receipts are listed on a stock exchange shall ensure that:

(i) the listed security receipts are valued at the end of each quarter i.e. as on March 31, June 30, September 30 and December 31 of every year;

(ii) valuation is conducted by an independent valuer; and

(iii) the net asset value is calculated on the basis of such independent valuation and the same is declared by the asset reconstruction company within fifteen days of the end of the quarter.

(2) The issuer shall also comply with the extant Reserve Bank of India requirement of obtaining credit rating of security receipts at half yearly interval and declaration of the net asset value thereafter and/or any other requirement as prescribed by the Reserve Bank of India from time to time.

Provided that in those two quarters in a year, where both external valuation and credit rating are required, issuer shall disclose lower of the two calculated Net Asset Value.

Terms of Security Receipts

87D. (1) Any security receipt issued would be transferable only in favour of qualified buyers in terms of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

(2) Unless the terms of issue provide otherwise, the listed entity shall not select any of its listed security receipts for payments otherwise than on pro rata basis or by lot and shall promptly submit to the stock exchange(s) the details thereof.

Record Date

87E. (1) The listed entity shall fix a record date for payment to holders of security receipts or for such other purposes as specified by the stock exchange(s).

(2) The listed entity shall give notice in advance of at least seven working days (excluding the date of intimation and the record date) to the stock exchange(s) of the record date or of as many days as the stock exchange may agree to or require specifying the purpose of the record date.

CHAPTER IX

OBLIGATIONS OF LISTED ENTITY WHICH HAS LISTED ITS MUTUAL FUND UNITS

Applicability

88. (1) The provisions of this chapter shall apply to the asset management company managing the mutual fund scheme whose units are listed on the recognised stock exchange(s).

(2) Notwithstanding anything contained in this chapter, the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and directions issued thereunder shall apply on the listed entity and to the schemes whose units are listed on the recognised stock exchange(s).

Definitions

89. The expressions "Asset Management Company", "Net Asset Value" , "Scheme" , "Unit" and "Unit Holder" shall have the same meaning as assigned to them under Securities and Exchange Board of India (Mutual Funds) Regulations, 1996;

Submission of Documents

90. (1) The listed entity shall intimate to the recognised stock exchange(s) the information relating to daily Net Asset Value, monthly portfolio, half yearly portfolio of those schemes whose units are listed on the recognised stock exchange(s) in the format as specified under Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and directions issued there under.

(2) The listed entity shall intimate to the recognised stock exchange(s) in the manner specified by the recognised stock exchange(s) of:

(a) movement in unit capital of those schemes whose units are listed on the recognised stock exchange(s);

(b) rating of the scheme whose units are listed on the recognised stock exchange(s) and any changes in the rating thereof (wherever applicable);

(c) imposition of penalties and material litigations against the listed entity and Mutual Fund;

(d) any prohibitory orders restraining the listed entity from transferring units registered in the name of the unit holders.

Dissemination on the website of stock exchange(s)

91. The listed entity shall submit such information and documents, which are required to be disseminated on the listed entity's website in terms of Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and directions issued there under, to the recognised stock exchange for dissemination.

CHAPTER X

DUTIES AND OBLIGATIONS OF THE RECOGNISED STOCK EXCHANGE(S)

Dissemination

92. (1) Upon receipt of relevant intimations, information, filings, reports, statements, documents or any other submissions in terms of these regulations, from the listed entity the recognised stock exchange(s) shall immediately disseminate the same on its website.

(2) The disseminations by the recognised stock exchange(s) as mentioned in sub-regulation (1) shall be made in organised, user friendly and easily referable manner including by providing hyperlinks for easy accessibility.

Transferability

93. The recognised stock exchange(s) shall coordinate with Depositories to ensure compliance with the applicable laws or directions of the Board or any competent court with regard to freezing / unfreezing, lock-in/ release of lock-in with respect to securities issued or managed by the listed entity.

Draft Scheme of Arrangement & Scheme of Arrangement

94. (1) The designated stock exchange, upon receipt of draft schemes of arrangement and the documents prescribed by the Board, as per sub-regulation (1) of regulation 37, shall forward the same to the Board, in the manner prescribed by the Board.

(2) The stock exchange(s) shall submit to the Board its Objection Letter or No-Objection Letter on the draft scheme of arrangement after inter-alia ascertaining whether the draft scheme of arrangement is in compliance with securities laws within thirty days of receipt of draft scheme of arrangement or within seven days of date of receipt of satisfactory reply on clarifications from the listed entity and/or opinion from independent chartered accountant, if any, sought by stock exchange(s), as applicable.

(3) The stock exchange(s), shall issue Observation Letter or No-objection letter to the listed entity within seven days of receipt of comments from the Board, after suitably incorporating such comments in the Observation Letter or No-objection letter:

Provided that the validity of the 'Observation Letter' or No-objection letter of stock exchanges shall be six months from the date of issuance.

(4) The stock exchange(s) shall bring the observations or objections, as the case may be, to the notice of Court or Tribunal at the time of approval of the scheme of arrangement.

(5) Upon sanction of the Scheme by the Court or Tribunal, the designated stock exchange shall forward its recommendations to the Board on the documents submitted by the listed entity in terms of sub-regulation (5) of regulation 37.

Statement on Impact of Audit Qualifications accompanying Annual Audit Report

95. The recognised stock exchange(s) shall review the Statement on Impact of Audit Qualifications and the accompanying annual audit report submitted in terms of clause (d) of sub-regulation (3) of regulation 33 and clause (a) of sub-regulation (3) of regulation 52.

Grievance Redressal

96. The recognised stock exchange(s) shall redress/facilitate redressal of complaints of holders of listed securities from time to time.

Monitoring of Compliance/Non Compliance & Adequacy/ Accuracy of the disclosures

97. (1) The recognised stock exchange(s) shall monitor compliance by the listed entity with provisions of these regulations.

(2) The recognised stock exchange(s) shall also monitor adequacy/ accuracy of the disclosures made by listed entity with respect to provisions of these regulations.

(3) The recognised stock exchange(s) shall submit a report to the Board, with respect to the obligations specified in sub-regulations (1) and (2), in the manner specified by the Board.

(4) The recognised stock exchange(s) shall put in place appropriate framework including adequate manpower and such infrastructure as may be required to comply with the provisions of this regulation.

CHAPTER XI

PROCEDURE FOR ACTION IN CASE OF DEFAULT

Liability for contravention of the Act, rules or the regulations

98. (1) The listed entity or any other person thereof who contravenes any of the provisions of these regulations, shall, in addition to liability for action in terms of the securities laws, be liable for the following actions by the respective stock exchange(s), in the manner specified in circulars or guidelines issued by the Board:

(a) imposition of fines;

(b) suspension of trading;

(c) freezing of promoter/promoter group holding of designated securities, as may be applicable, in coordination with depositories.

(d) any other action as may be specified by the Board from time to time

(2) The manner of revocation of actions specified in clauses (b) and (c) of sub-regulation (1), shall be as specified in circulars or guidelines issued by the Board.

Failure to pay fine

99. If listed entity fails to pay any fine imposed on it within such period as specified from time to time, by the recognised stock exchange(s), after a notice in writing has been served on it, the stock exchange may initiate action.

CHAPTER XII

MISCELLANEOUS

Amendments to other regulations

100. The regulations specified in the Schedule IX to these regulations shall be amended in the manner and to the extent stated therein.

Power to remove difficulties

101. (1) In order to remove any difficulties in the application or interpretation of these regulations, the Board may issue clarifications through guidance notes or circulars after recording reasons in writing.

(2) In particular, and without prejudice to the generality of the foregoing power, such guidance notes or circulars may provide for all or any of the following matters, namely:

(a) procedural aspects including intimation to be given, documents to be submitted;

(b) disclosure requirements;

(c) listing conditions.

Power to relax strict enforcement of the regulations

102. (1) The Board may in the interest of investors and securities market and for the development of the securities market, relax the strict enforcement of any requirement of these regulations, if the Board is satisfied that:

(a) any provision of Act(s), Rule(s), regulation(s) under which the listed entity is established or is governed by, is required to be given precedence to; or

(b) the requirement may cause undue hardship to investors; or

(c) the disclosure requirement is not relevant for a particular industry or class of listed entities; or

(d) the requirement is technical in nature; or

(e) the non-compliance is caused due to factors affecting a class of entities but being beyond the control of the entities.

(2) For seeking relaxation under sub-regulation (1), an application, giving details and the grounds on which such relaxation has been sought, shall be filed with the Board.

(3) The application referred to under sub-regulation (2) shall be accompanied by a non-refundable fee of rupees one lakh payable by way of direct credit in the bank account through NEFT/ RTGS/ IMPS or any other mode allowed by Reserve Bank of India or by way of a demand draft in favour of the Board payable in Mumbai.

Repeal and Savings

103. (1) On and from the commencement of these regulations, all circulars stipulating or modifying the provisions of the listing agreements including those specified in **Schedule X**, shall stand rescinded.

(2) Notwithstanding such rescission, anything done or any action taken or purported to have been done or taken including any enquiry or investigation commenced or show cause notice issued in respect of the circulars specified in sub-regulation (1) or the Listing Agreements, entered into between stock exchange(s) and listed entity, in force prior to the commencement of these regulations, shall be deemed to have been done or taken under the corresponding provisions of these regulations.

CHAPTER 3

SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

CHAPTER I

PRELIMINARY

Short title and commencement

1. (1) These regulations may be called the SEBI (Prohibition of Insider Trading) Regulations, 2015.

(2) These regulations shall come into force on the one hundred and twentieth day from the date of its publication in the Official Gazette.

Definitions.

2. (1) In these regulations, unless the context otherwise requires, the following words, expressions and derivations therefrom shall have the meanings assigned to them as under:–

(a) "Act" means the Securities and Exchange Board of India Act, 1992 (15 of1992);

(b) "Board" means the Securities and Exchange Board of India;

(c) "compliance officer" means any senior officer, designated so and reporting to the board of directors or head of the organization in case board is not there, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under the overall supervision of the board of directors of the listed company or the head of an organization, as the case maybe.

Explanation – For the purpose of this regulation, "financially literate" shall mean a person who has the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows;

(d) "connected person "means,-

(i) any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

(ii) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be connected persons unless the contrary is established,-

(a) an immediate relative of connected persons specified in clause (i);or

(b) a holding company or associate company or subsidiary company; or

(c) an intermediary as specified in section 12 of the Act or an employee or director thereof; or

(d) an investment company, trustee company, asset management company or an employee or director thereof; or

(e) an official of a stock exchange or of clearing house or corporation ;or

(f) a member of board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or

(g) a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013;or

(h) an official or an employee of a self-regulatory organization recognised or authorized by the Board; or

(i) a banker of the company; or

(j) a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent. of the holding or interest;

NOTE: *It is intended that a connected person is one who has a connection with the company that is expected to put him in possession of unpublished price sensitive* *information. Immediate relatives and other categories of persons specified above are also presumed to be connected persons but such a presumption is a deeming legal fiction and is rebuttable. This definition is also intended to bring into its ambit persons who may not seemingly occupy any position in a company but are in regular touch with the company and its officers and are involved in the know of the company's operations. It is intended to bring within its ambit those who would have access to or could access unpublished price sensitive information about any company or class of companies by virtue of any connection that would put them in possession of unpublished price sensitive information.*

(e) "generally available information" means information that is accessible to the public on a non-discriminatory basis;

NOTE: *It is intended to define what constitutes generally available information so that it is easier to crystallize and appreciate what unpublished price sensitive information is. Information published on the website of a stock exchange, would ordinarily be considered generally available.*

(f) "immediate relative" means a spouse of a person, and includes parent, sibling, and child of such person or of the spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities;

NOTE: *It is intended that the immediate relatives of a "connected person" too become connected persons for purposes of these regulations. Indeed, this is a rebuttable presumption.*

(g) "insider" means any person who is:

(i) a connected person; or

(ii) in possession of or having access to unpublished price sensitive information;

NOTE: *Since "generally available information" is defined, it is intended that anyone in possession of or having access to unpublished price sensitive information should be considered an "insider" regardless of how one came in possession of or had access to such information. Various circumstances are provided for such a person to demonstrate that he has not indulged in insider trading. Therefore, this definition is intended to bring within its reach any person who is in receipt of or has access to unpublished price sensitive information. The onus of showing that a certain person was in possession of or had access to unpublished price sensitive information at the time of trading would, therefore, be on the person leveling the charge after which the person who has traded when in possession of or having access to unpublished price sensitive information may demonstrate that he was not in such possession or that he has not traded or or he could not access or that his trading when in possession of such information was squarely covered by the exonerating circumstances.*

(h) "promoter" shall have the meaning assigned to it under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations,2018 or any modification hereof;

(ha) "promoter group" shall have the meaning assigned to it under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 or any modification thereof;

(hb) “proposed to be listed” shall include securities of an unlisted company:

(i) if such unlisted company has filed offer documents or other documents, as the case may be, with the Board, stock exchange(s) or registrar of companies in connection with the listing; or

(ii) if such unlisted company is getting listed pursuant to any merger or amalgamation and has filed a copy of such scheme of merger or amalgamation under the Companies Act, 2013;

(i) "securities" shall have the meaning assigned to it under the Securities Contracts (Regulation) Act, 1956 (42 of 1956) or any modification thereof except units of a mutual fund;

(j)"specified" means specified by the Board inwriting;

(k) “takeover regulations” means the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and any amendments thereto;

(l)"trading" means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities, and "trade" shall be construed accordingly;

NOTE: *Under the parliamentary mandate, since the Section 12A (e) and Section 15G of the Act employs the term 'dealing in securities', it is intended to widely define the term “trading” to include dealing. Such a construction is intended to curb the activities based on unpublished price sensitive information which are strictly not buying, selling or subscribing, such as pledging etc when in possession of unpublished price sensitive information.*

(m) “trading day” means a day on which the recognized stock exchanges are open for trading;

(n)"unpublished price sensitive information" means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:–

(i) financial results;

(ii) dividends;

(iii) change in capital structure;

(iv) mergers, de-mergers, acquisitions, de listings, disposals and expansion of business and such other transactions;

(v) changes in key managerial personnel.

***NOTE**: It is intended that information relating to a company or securities, that is not generally available would be unpublished price sensitive information if it is likely to materially affect the price upon coming into the public domain. The types of matters that would ordinarily give rise to unpublished price sensitive information have been listed above to give illustrative guidance of unpublished price sensitive information.*

(2) Words and expressions used and not defined in these regulations but defined in the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Depositories Act, 1996 (22 of 1996) or the Companies Act, 2013 (18 of 2013) and rules and regulations made thereunder shall have the meanings respectively assigned to them in those legislation.

CHAPTER – II

RESTRICTIONS ON COMMUNICATION AND TRADING BY INSIDERS

Communication or procurement of unpublished price sensitive information.

3. (1) No insider shall communicate, provide, or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

***NOTE**: This provision is intended to cast an obligation on all insiders who are essentially persons in possession of unpublished price sensitive information to handle such information with care and to deal with the information with them when transacting their business strictly on a need-to-know basis. It is also intended to lead to organisations developing practices based on need-to-know principles for treatment of information in their possession.*

(2) No person shall procure from or cause the communication by any insider of unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, except in furtherance of legitimate purposes, performance of duties or discharge of legal obligations.

NOTE: This provision is intended to impose a prohibition on unlawfully procuring possession of unpublished price sensitive information. Inducement and procurement of unpublished price sensitive information not in furtherance of one's legitimate duties and discharge of obligations would be illegal under this provision.

(2A) The board of directors of a listed company shall make a policy for determination of "legitimate purposes" as a part of "Codes of Fair Disclosure and Conduct" formulated under regulation 8.

Explanation – For the purpose of illustration, the term "legitimate purpose" shall include sharing of unpublished price sensitive information in the ordinary course of business by an insider with partners, collaborators, lenders, customers, suppliers, merchant bankers, legal advisors, auditors, insolvency professionals or other advisors or consultants, provided that such sharing has not been carried out to evade or circumvent the prohibitions of these regulations.

(2B) Any person in receipt of unpublished price sensitive information pursuant to a "legitimate purpose" shall be considered an "insider" for purposes of these regulations and due notice shall be given to such persons to maintain confidentiality of such unpublished price sensitive information in compliance with these regulations.

(3) Notwithstanding anything contained in this regulation, an unpublished price sensitive information may be communicated, provided, allowed access to or procured, in connection with a transaction that would:–

(i) entail an obligation to make an open offer under the takeover regulations where the board of directors of the listed company is of informed opinion that sharing of such information is in the best interests of the company;

NOTE: *It is intended to acknowledge the necessity of communicating, providing, allowing access to or procuring UPSI for substantial transactions such as takeovers, mergers and acquisitions involving trading in securities and change of control to assess a potential investment. In an open offer under the takeover regulations, not only would the same price be made available to all shareholders of the company but also all information necessary to enable an informed divestment or retention decision by the public shareholders is required to be made available to all shareholders in the letter of offer under those regulations.*

(ii) not attract the obligation to make an open offer under the takeover regulations but where the board of directors of the listed company is of informed opinion that sharing of such information is in the best interests of the company and the information that constitute unpublished price sensitive information is disseminated to be made generally available at least two trading days prior to the proposed transaction being effected in such form as the board of directors may determine to be adequate and fair to cover all relevant and material facts.

NOTE: *It is intended to permit communicating, providing, allowing access to or procuring UPSI also in transactions that do not entail an open offer obligation under the takeover regulations when authorised by the board of directors if sharing of such information is in the best interests of the company. The board of directors, however, would cause public disclosures of such unpublished price sensitive information well before the proposed transaction to rule out any information asymmetry in the market.*

(4) For purposes of sub-regulation (3), the board of directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties

and such parties shall keep information so received confidential, except for the purpose of sub-regulation (3), and shall not otherwise trade in securities of the company when in possession of unpublished price sensitive information.

(5) The board of directors shall ensure that a structured digital database is maintained containing the names of such persons or entities as the case may be with whom information is shared under this regulation along with the Permanent Account Number or any other identifier authorized by law where Permanent Account Number is not available. Such databases shall be maintained with adequate internal controls and checks such as time stamping and audit trails to ensure non-tampering of the database.

Trading when in possession of unpublished price sensitive information.

4. (1) No insider shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of unpublished price sensitive information:

Explanation – When a person who has traded in securities has been in possession of unpublished price sensitive information, his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession.

Provided that the insider may prove his innocence by demonstrating the circumstances including the following: –

(i) the transaction is an off-market *inter-se* transfer between insiders who were in possession of the same unpublished price sensitive information without being in breach of regulation 3 and both parties had made a conscious and informed trade decision.

Provided that such unpublished price sensitive information was not obtained under sub-regulation (3) of regulation 3 of these regulations.

Provided further that such off-market trades shall be reported by the insiders to the company within two working days. Every company shall notify the particulars of such trades to the stock exchange on which the securities are listed within two trading days from receipt of the disclosure or from becoming aware of such information.

(ii) the transaction was carried out through the block deal window mechanism between persons who were in possession of the unpublished price sensitive information without being in breach of regulation 3 and both parties had made a conscious and informed trade decision;

Provided that such unpublished price sensitive information was not obtained by either person under sub-regulation (3) of regulation 3 of these regulations.

(iii) the transaction in question was carried out pursuant to a statutory or regulatory obligation to carry out a bona fide transaction.

(iv) the transaction in question was undertaken pursuant to the exercise of stock options in respect of which the exercise price was pre-determined in compliance with applicable regulations.

(v) in the case of non-individual insiders:–

(a) the individuals who were in possession of such unpublished price sensitive information were different from the individuals taking trading decisions and such decision-making individuals were not in possession of such unpublished price sensitive information when they took the decision to trade; and

(b) appropriate and adequate arrangements were in place to ensure that these regulations are not violated and no unpublished price sensitive information was communicated by the individuals possessing the information to the individuals taking trading decisions and there is no evidence of such arrangements having been breached;

(vi) the trades were pursuant to a trading plan set up in accordance with regulation5.

NOTE*: When a person who has traded in securities has been in possession of unpublished price sensitive information, his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession. The reasons for which he trades or the purposes to which he applies the proceeds of the transactions are not intended to be relevant for determining whether a person has violated the regulation. He traded when in possession of unpublished price sensitive information is what would need to be demonstrated at the outset to bring a charge. Once this is established, it would be open to the insider to prove his innocence by demonstrating the circumstances mentioned in the proviso, failing which he would have violated the prohibition.*

(2) In the case of connected persons the onus of establishing, that they were not in possession of unpublished price sensitive information, shall be on such connected persons and in other cases, the onus would be on the Board.

(3) The Board may specify such standards and requirements, from time to time, as it may deem necessary for the purpose of these regulations.

Trading Plans.

5. (1) An insider shall be entitled to formulate a trading plan and present it to the compliance officer for approval and public disclosure pursuant to which trades may be carried out on his behalf in accordance with such plan.

NOTE*: This provision intends to give an option to persons who may be perpetually in possession of unpublished price sensitive information and enabling them to trade in securities in a compliant manner. This provision would enable the formulation of a trading plan by an insider to enable him to plan for trades to be executed in future. By doing so, the possession of unpublished price sensitive information when a trade under a trading plan is actually executed would not prohibit the* *execution of such trades that he had pre-decided even before the unpublished price sensitive information came into being.*

(2) Such trading plan shall:–

(i) not entail commencement of trading on behalf of the insider earlier than six months from the public disclosure of the plan;

NOTE*: It is intended that to get the benefit of a trading plan, a cool-off period of six months is necessary. Such a period is considered reasonably long for unpublished price sensitive information that is in possession of the insider when formulating the trading plan, to become generally available. It is also considered to be a reasonable period for a time lag in which new unpublished price sensitive information may come into being without adversely affecting the trading plan formulated earlier. In any case, it should be remembered that this is only a statutory cool-off period and would not grant immunity from action if the insider were to be in possession of the same unpublished price sensitive information both at the time of formulation of the plan and implementation of the same.*

(ii) not entail trading for the period between the twentieth trading day prior to the last day of any financial period for which results are required to be announced by the issuer of the securities and the second trading day after the disclosure of such financial results;

NOTE*: Since the trading plan is envisaged to be an exception to the general rule prohibiting trading by insiders when in possession of unpublished price sensitive information, it is important that the trading plan does not entail trading for a reasonable period around the declaration of financial results as that would generate unpublished price sensitive information.*

(iii) entail trading for a period of not less than twelve months;

NOTE*: It is intended that it would be undesirable to have frequent announcements of trading plans for short periods of time rendering meaningless the defence of a reasonable time gap between the decision to trade and the actual trade. Hence it is felt that a reasonable time would be twelve months.*

(iv) not entail overlap of any period for which another trading plan is already in existence;

NOTE*: It is intended that it would be undesirable to have multiple trading plans operating during the same time period. Since it would be possible for an insider to time the publication of the unpublished price sensitive information to make it generally available instead of timing the trades, it is important not to have the ability to initiate more than one plan covering the same time period.*

(v) set out either the value of trades to be effected or the number of securities to be traded along with the nature of the trade and the intervals at, or dates on which such trades shall be effected; and

NOTE: *It is intended that while regulations should not be too prescriptive and rigid about what a trading plan should entail, they should stipulate certain basic parameters that a trading plan should conform to and within which, the plan may be formulated with full flexibility. The nature of the trades entailed in the trading plan i.e. acquisition or disposal should be set out. The trading plan may set out the value of securities or the number of securities to be invested or divested. Specific dates or specific time intervals may be set out in the plan.*

(vi) not entail trading in securities for market abuse.

NOTE: *Trading on the basis of such a trading plan would not grant absolute immunity from bringing proceedings for market abuse. For instance, in the event of manipulative timing of the release of unpublished price sensitive information to ensure that trading under a trading plan becomes lucrative in circumvention of regulation 4 being detected, it would be open to initiate proceedings for alleged breach of SEB I (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 2003.*

(3) The compliance officer shall review the trading plan to assess whether the plan would have any potential for violation of these regulations and shall be entitled to seek such express undertakings as may be necessary to enable such assessment and to approve and monitor the implementation of the plan.

Provided that pre-clearance of trades shall not be required for a trade executed as per an approved trading plan.

Provided further that trading window norms and restrictions on contra trade shall not be applicable for trades carried out in accordance with an approved trading plan.

NOTE: *It is intended that the compliance officer would have to review and approve the plan. For doing so, he may need the insider to declare that he is not in possession of unpublished price sensitive information or that he would ensure that any unpublished price sensitive information in his possession becomes generally available before he commences executing his trades. Once satisfied, he may approve the trading plan, which would then have to be implemented in accordance with these regulations.*

(4) The trading plan once approved shall be irrevocable and the insider shall mandatorily have to implement the plan, without being entitled to either deviate from it or to execute any trade in the securities outside the scope of the trading plan.

Provided that the implementation of the trading plan shall not be commenced if any unpublished price sensitive information in possession of the insider at the time of formulation of the plan has not become generally available at the time of the commencement of implementation and in such event the compliance officer shall confirm that the commencement ought to be deferred until such unpublished price sensitive information becomes generally available information so as to avoid a violation of sub-regulation (1) of regulation 4.

NOTE: *It is intended that since the trading plan is an exception to the general rule that an insider* *should not trade when in possession of unpublished price sensitive information, changing the plan or trading outside the same would negate the intent behind the exception. Other investors in the market, too, would factor the impact of the trading plan on their own trading decisions and in price discovery. Therefore, it is not fair or desirable to permit the insider to deviate from the trading plan based on which others in the market have assessed their views on the securities.*

The proviso is intended to address the prospect that despite the six-month gap between the formulation of the trading plan and its commencement, the unpublished price sensitive information in possession of the insider is still not generally available. In such a situation, commencement of the plan would conflict with the over-riding principle that trades should not be executed when in possession of such information. If the very same unpublished price sensitive information is still in the insider's possession, the commencement of execution of the trading plan ought to be deferred.

(5) Upon approval of the trading plan, the compliance officer shall notify the plan to the stock exchanges on which the securities are listed.

NOTE*: It is intended that given the material exception to the prohibitory rule in regulation 4, a trading plan is required to be publicly disseminated. Investors in the market at large would also factor the potential pointers in the trading plan in their own assessment of the securities and price discovery for them on the premise of how the insiders perceive the prospects or approach the securities in their trading plan.*

CHAPTER – III

DISCLOSURES OF TRADING BY INSIDERS

General provisions.

6. (1) Every public disclosure under this Chapter shall be made in such form as may be specified.

(2) The disclosures to be made by any person under this Chapter shall include those relating to trading by such person's immediate relatives, and by any other person for whom such person takes trading decisions.

NOTE*: It is intended that disclosure of trades would need to be of not only those executed by the person concerned but also by the immediate relatives and of other persons for whom the person concerned takes trading decisions. These regulations are primarily aimed at preventing abuse by trading when in possession of unpublished price sensitive information and therefore, what matters is whether the person who takes trading decisions is in possession of such information rather than whether the person who has title to the trades is in such possession.*

(3) The disclosures of trading in securities shall also include trading in derivatives of securities and the traded value of the derivatives shall be taken into account for purposes of this Chapter:

Provided that trading in derivatives of securities is permitted by any law for the time being in force.

(4) The disclosures made under this Chapter shall be maintained by the company, for a minimum period of five years, in such form as may be specified.

Disclosures by certain persons.

7. (1) *Initial Disclosures.*

(a) Every promoter, member of the promoter group , key managerial personnel and director of every company whose securities are listed on any recognised stock exchange shall disclose his holding of securities of the company as on the date of these regulations taking effect, to the company within thirty days of these regulations taking effect;

(b) Every person on appointment as a key managerial personnel or a director of the company or upon becoming a promoter or member of the promoter group] shall disclose his holding of securities of the company as on the date of appointment or becoming a promoter, to the company within seven days of such appointment or becoming a promoter.

(2) *Continual Disclosures.*

(a) Every promoter member of the promoter group designated person and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to a traded value in excess of ten lakh rupees or such other value as may be specified;

(b) Every company shall notify the particulars of such trading to the stock exchange on which the securities are listed within two trading days of receipt of the disclosure or from becoming aware of such information.

Explanation. — It is clarified for the avoidance of doubts that the disclosure of the incremental transactions after any disclosure under this sub-regulation, shall be made when the transactions effected after the prior disclosure cross the threshold specified in clause (a) of sub-regulation (2).

Disclosures by other connected persons.

(3) Any company whose securities are listed on a stock exchange may, at its discretion require any other connected person or class of connected persons to make disclosures of holdings and trading in securities of the company in such form and at such frequency as may be determined by the company in order to monitor compliance with these regulations.

NOTE: *This is an enabling provision for listed companies to seek information from those to whom it has to provide unpublished price sensitive information. This provision confers discretion on any company to seek such information. For example, a listed company may ask that a management consultant who would advise it on corporate strategy and would need to review unpublished price sensitive information, should make disclosures of his trades to the company.*

CHAPTER – IV

CODES OF FAIR DISCLOSURE AND CONDUCT

Code of Fair Disclosure.

8. (1) The board of directors of every company, whose securities are listed on a stock exchange, shall formulate and publish on its official website, a code of practices and procedures for fair disclosure of unpublished price sensitive information that it would follow in order to adhere to each of the principles set out in Schedule A to these regulations, without diluting the provisions of these regulations in any manner.

***NOTE**: This provision intends to require every company whose securities are listed on stock exchanges to formulate a stated framework and policy for fair disclosure of events and occurrences that could impact price discovery in the market for its securities. Principles such as, equality of access to information, publication of policies such as those on dividend, inorganic growth pursuits, calls and meetings with analysts, publication of transcripts of such calls and meetings, and the like are set out in the schedule.*

(2) Every such code of practices and procedures for fair disclosure of unpublished price sensitive information and every amendment thereto shall be promptly intimated to the stock exchanges where the securities are listed.

***NOTE**: This provision is aimed at requiring transparent disclosure of the policy formulated in sub-regulation (1).*

Code of Conduct.

9. (1) The board of directors of every listed company and the board of directors or head(s) of the organisation of every intermediary shall ensure that the chief executive officer or managing director shall formulate a code of conduct with their approval to regulate, monitor and report trading by its designated persons and immediate relatives of designated persons] towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B (in case of a listed company) and Schedule C (in case of an intermediary) to these regulations, without diluting the provisions of these regulations in any manner.

Explanation – For the avoidance of doubt it is clarified that intermediaries, which are listed, would be required to formulate a code of conduct to regulate, monitor and report trading by their designated persons, by adopting the minimum standards set out in Schedule B with respect to trading in their own securities and in Schedule C with respect to trading in other securities.

***NOTE**: It is intended that every company whose securities are listed on stock exchanges and every intermediary registered with SEBI is mandatorily required to formulate a code of conduct governing trading by designated persons and their immediate relatives. The standards set out in the schedules are required to be addressed by such code of conduct.*

(2) The board of directors or head(s) of the organisation, of every other person who is required to handle unpublished price sensitive information in the course of business operations shall formulate a code of conduct to regulate, monitor and report trading by their designated persons and immediate relative of designated persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule C to these regulations, without diluting the provisions of these regulations in any manner.

Explanation - Professional firms such as auditors, accountancy firms, law firms, analysts, insolvency professional entities, consultants, banks etc., assisting or advising listed companies shall be collectively referred to as fiduciaries for the purpose of these regulations.

***NOTE**: This provision is intended to mandate persons other than listed companies and intermediaries that are required to handle unpublished price sensitive information to formulate a code of conduct governing trading in securities by their designated persons. These entities include professional firms such as auditors, accountancy firms, law firms, analysts, insolvency professional entities, consultants, banks etc., assisting or advising listed companies. Even entities that normally operate outside the capital market may handle unpublished price sensitive information. This provision would mandate all of them to formulate a code of conduct.*

(3) Every listed company, intermediary and other persons formulating a code of conduct shall identify and designate a compliance officer to administer the code of conduct and other requirements under these regulations.

***NOTE**: This provision is intended to designate a senior officer as the compliance officer with the responsibility to administer the code of conduct and monitor compliance with these regulations.*

(4) For the purpose of sub regulation (1) and (2), the board of directors or such other analogous authority shall in consultation with the compliance officer specify the designated persons to be covered by the code of conduct on the basis of their role and function in the organisation and the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation and shall include:-

(i) Employees of such listed company, intermediary or fiduciary designated on the basis of their functional role or access to unpublished price sensitive information in the organization by their board of directors or analogous body;

(ii) Employees of material subsidiaries of such listed companies designated on the basis of their functional role or access to unpublished price sensitive information in the organization by their board of directors;

(iii) All promoters of listed companies and promoters who are individuals or investment companies for intermediaries or fiduciaries;

(iv) Chief Executive Officer and employees upto two levels below Chief Executive Officer of such listed company, intermediary, fiduciary and its material subsidiaries irrespective of their functional role in the company or ability to have access to unpublished price sensitive information;

(v) Any support staff of listed company, intermediary or fiduciary such as IT staff or secretarial staff who have access to unpublished price sensitive information.

Institutional Mechanism for Prevention of Insider trading.

9A. (1) The Chief Executive Officer, Managing Director or such other analogous person of a listed company, intermediary or fiduciary shall put in place adequate and effective system of internal controls to ensure compliance with the requirements given in these regulations to prevent insider trading.

(2) The internal controls shall include the following:

(a) all employees who have access to unpublished price sensitive information are identified as designated employee;

(b) all the unpublished price sensitive information shall be identified and its confidentiality shall be maintained as per the requirements of these regulations;

(c) adequate restrictions shall be placed on communication or procurement of unpublished price sensitive information as required by these regulations;

(d) lists of all employees and other persons with whom unpublished price sensitive information is shared shall be maintained and confidentiality agreements shall be signed or notice shall be served to all such employees and persons;

(e) all other relevant requirements specified under these regulations shall be complied with;

(f) periodic process review to evaluate effectiveness of such internal controls.

(3) The board of directors of every listed company and the board of directors or head(s) of the organisation of intermediaries and fiduciaries shall ensure that the Chief Executive Officer or the Managing Director or such other analogous person ensures compliance with regulation 9 and sub-regulations (1) and (2) of this regulation.

(4) The Audit Committee of a listed company or other analogous body for intermediary or fiduciary shall review compliance with the provisions of these regulations at least once in a financial year and shall verify that the systems for internal control are adequate and are operating effectively.

(5) Every listed company shall formulate written policies and procedures for inquiry in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, which shall be approved by board of directors of the company and accordingly initiate appropriate inquiries on becoming aware of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information and inform the Board promptly of such leaks, inquiries and results of such inquiries.

(6) The listed company shall have a whistle-blower policy and make employees aware of such policy to enable employees to report instances of leak of unpublished price sensitive information.

(7) If an inquiry has been initiated by a listed company in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, the relevant intermediaries and fiduciaries shall co-operate with the listed company in connection with such inquiry conducted by listed company.

CHAPTER – V

MISCELLANEOUS

Sanction for violations.

10. Any contravention of these regulations shall be dealt with by the Board in accordance with the Act.

Power to remove difficulties.

11. In order to remove any difficulties in the interpretation or application of the provisions of these regulations, the Board shall have the power to issue directions through guidance notes or circulars:

Provided that where any direction is issued by the Board in a specific case relating to interpretation or application of any provision of these regulations, it shall be done only after affording a reasonable opportunity of being heard to the concerned persons and after recording reasons for the direction.

Repeal and Savings.

12. (1) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 are here by repealed.

(2) Notwithstanding such repeal,—

(a) the previous operation of the repealed regulations or anything duly done or suffered thereunder, any right, privilege, obligation or liability acquired, accrued or incurred under the repealed regulations, any penalty, forfeiture or punishment incurred in respect of any offence committed against the repealed regulations, or any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, shall remain unaffected as if the repealed regulations had never been repealed; and

(b) anything done or any action taken or purported to have been done or taken including any adjudication, enquiry or investigation commenced or show-cause notice issued under the repealed regulations prior to such repeal, shall be deemed to have been done or taken under the corresponding provisions of these regulations;

(3) After the repeal of Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations,1992, any reference thereto in any other regulations made, guidelines or circulars issued thereunder by the Board shall be deemed to be a reference to the corresponding provisions of these regulations.

CHAPTER 4

SEBI (BUY BACK OF SECURITIES) REGULATIONS, 2018

CHAPTER I

PRELIMINARY

Short title and commencement

1. (i) These regulations may be called the Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 2018.

(ii) These regulations shall come into force on the date of their publication in the Official Gazette.

Definitions

2. (i) In these regulations, unless the context otherwise requires:—

(a) 'Act' means the Securities and Exchange Board of India Act, 1992 (15 of1992);

(b) 'associate' includes a person,—

(i) who directly or indirectly by himself or in combination with relatives, exercise control over the company or,

(ii) whose employee, officer or director is also a director, officer or employee of company;

(c) "Board" means the Securities and Exchange Board of India established under section 3 of the Act;

(d) 'Buyback period' means the period between the date of board of directors resolution or date of declaration of results of the postal ballot for special resolution, as the case may be, to authorize buyback of shares of the company and the date on which the payment of consideration to shareholders who have accepted the buyback offer is made;

(e) ‘control’ has the same meaning as defined in clause (e) of sub- regulation (1) of regulation (2) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations,2011;

(f) ‘company’ means a company as defined under the Companies Act, whose shares or other specified securities are listed on a Stock Exchange and which buys or intends to buy such shares or other specified securities in accordance with these regulations;

(g) ‘Companies Act’ means the Companies Act, 2013.

(h) ‘insider’ means an insider as defined in clause(g) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015;

(i) ‘merchant banker’ means a merchant banker as defined in clause (cb) of regulation 2 of the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992 and registered under section 12 of the Act;

(j) ‘odd lots’ mean the lots of shares or other specified securities of a company, whose shares are listed on a recognised stock exchange, which are smaller than such marketable lots, as may be specified by the stock exchange;

(k) ‘promoter’ means promoter as defined in clause (s) of sub- regulation (1) of regulation 2 of the Securities and Exchange Board of India(Substantial Acquisition of Shares and Takeovers) Regulations,2011;

(l) ‘registrar’ means a registrar to an issue and includes a share transfer agent, registered under section 12 of the Act;

(m)‘securities’ mean securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of1956);

(n) ‘small shareholder’ means a shareholder of a company, who holds shares or other specified securities whose market value, on the basis of closing price of shares or other specified securities, on the recognised stock exchange in which highest trading volume in respect of such securities, as on record date is not more than two lakh rupee;

(o) ‘specified securities’ includes employees’ stock option or other securities as may be notified by the Central Government from time to time;

(p) ‘statutory auditor’ means an auditor appointed by a company under section 139 of the Companies Act;

(q) ‘stock exchange’ means a stock exchange which has been granted recognition under section 4 of the Securities Contracts (Regulation) Act, 1956 (42 of1956);

(r) 'tender offer' means an offer by a company to buy-back its own shares or other specified securities through a letter of offer from the holders of the shares or other specified securities of the company;

(s) 'unpublished price sensitive information' has the same meaning as defined in clause (n) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations,2015;

(t) 'working day' means any working day of the Board.

All other expressions unless defined herein shall have the same meaning as has been assigned to them under the Act or the Securities Contracts (Regulation) Act, 1956, or Companies Act or any statutory modification or re-enactment thereof, as the case maybe.

CHAPTER II

CONDITIONS OF BUY BACK

Applicability:

3. These regulations shall be applicable to buy-back of shares or other specified securities of a company in accordance with the applicable provisions of the Companies Act.

Conditions and requirements for buy-back of shares and specified securities:

4. (i) The maximum limit of any buy-back shall be twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company:

Explanation**:** In respect of the buy-back of equity shares in any financial year, the reference to twenty-five per cent in this regulation shall be construed with respect to its total paid-up equity capital in that financial year;

(ii) The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back shall not be more than twice the paid-up capital and free reserves.

Provided that if a higher ratio of the debt to capital and free reserves for the company has been notified under the Companies Act, 2013, the same shall prevail.

(iii) All shares or other specified securities for buy-back shall be fully paid- up.

(iv) A company may buy-back its shares or other specified securities by any one of the following methods:

(a) from the existing shareholders or other specified securities holders on a proportionate basis through the tender offer;

(b) from the open market through—

(i) book-building process,

(ii) stock exchange;

(c) from odd-lot holders:

Provided that no offer of buy-back for fifteen per cent or more of the paid up capital and free reserves of the company shall be made from the open market.

(v) A company shall not buy-back its shares or other specified securities so as to delist its shares or other specified securities from the stock exchange.

(vi) A company shall not buy-back its shares or other specified securities from any person through negotiated deals, whether on or off the stock exchange or through spot transactions or through any private arrangement.

(vii) A company shall not make any offer of buy-back within a period of one year reckoned from the date of expiry of buyback period of the preceding offer of buy-back, if any.

(viii) A company shall not allow buy-back of its shares unless the consequent reduction of its share capital is effected.

(ix) A company may undertake a buy-back of its own shares or other specified securities out of—

(a) its free reserves;

(b) the securities premium account; or

(c) the proceeds of the issue of any shares or other specified securities:

Provided that no such buy-back shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

(x) No company shall directly or indirectly purchase its own shares or other specified securities:

(a) through any subsidiary company including its own subsidiary companies;

(b) through any investment company or group of investment companies; or

(c) if a default is made by the company in the repayment of deposits accepted either before or after the commencement of the Companies Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company:

Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

General compliance and filing requirements for buy-back:

5. (i) The company shall not authorise any buy-back (whether by way of tender offer or from open market or odd lot) unless:

(a) The buy-back is authorised by the company's articles;

(b) A special resolution has been passed at a general meeting of the company authorising the buy-back:

Provided that nothing contained in this clause shall apply to a case where the buy-back is, ten per cent or less of the total paid-up equity capital and free reserves of the company; and such buy-back has been authorised by the board of directors by means of a resolution passed at its meeting.

(ii) Every buy-back shall be completed within a period of one year from the date of passing of the special resolution at general meeting, or the resolution passed by the board of directors of the company, as the case maybe.

(iii) The company shall, after expiry of the buy-back period, file with the Registrar of Companies and the Board, a return containing such particulars relating to the buy-back within thirty days of such expiry, in the format as specified in the Companies (Share Capital and Debentures) Rules,2014.

(iv) Where a special resolution is required for authorizing a buy-back, the explanatory statement to be annexed with the notice for the general meeting pursuant to section 102 of the Companies Act shall contain mandatory disclosures mentioned therein and the following disclosures:

(a) Disclosures under sub-section 3 of section 68 of the Companies Act—

(i) a full and complete disclosure of all material facts;

(ii) the necessity for the buy-back;

(iii) the class of shares or securities intended to be purchased under the buy-back;

(iv) the amount to be invested under the buy-back; and

(v) the time-limit for completion of buy-back.

(b) Additional disclosures under these regulations as provided in **Schedule I,**

Provided that where the buy-back is through tender offer from existing securities holders , the explanatory statement shall contain the following additional disclosures:

(i) the maximum price at which the buy-back of shares or other specified securities shall be made and whether the board of directors of the company is being authorised at the general meeting to determine subsequently the specific price at which the buy-back may be made at the appropriate time;

(ii) if the promoter intends to offer his shares or other specified securities, the quantum of shares or other specified securities proposed to be tendered and the details of their transactions and their holdings for the last six months prior to the passing of the special resolution for buy-back including information of number of shares or other specified securities acquired, the price and the date of acquisition.

(v) A copy of the resolution passed at the general meeting under sub- section (2) of section 68 of the Companies Act shall be filed with the Board and the stock exchanges where the shares or other specified securities of the company are listed, within seven days from the date of passing of the resolution.

(vi) Where the buy-back is from open market either through the stock exchange or through book building, the resolution of board of directors shall specify the maximum price at which the buy-back shall be made:

Provided that where there is a requirement for the Special Resolution as specified in clause (b) of sub-regulation 1 of regulation 5 of these Regulations, the special resolution shall also specify the maximum price at which the buy-back shall be made.

(vii) A company, authorized by a resolution passed by the board of directors at its meeting to buy-back its shares or other specified securities under the proviso to clause (b) of sub-section (2) of section 68 of the Companies Act, shall file a copy of the resolution, with the Board and the stock exchanges, where the shares or other specified securities of the company are listed, within two working days of the date of the passing of the resolution.

(viii) No insider shall deal in shares or other specified securities of the company on the basis of unpublished price sensitive information relating to buy-back of shares or other specified securities of the company.

CHAPTER III

BUY-BACK THROUGH TENDER OFFER

6. A company may buy-back its shares or other specified securities from its existing securities holders on a proportionate basis in accordance with the provisions of this Chapter

Provided that fifteen per cent of the number of securities which the company proposes to buy-back or number of securities entitled as per their shareholding, whichever is higher, shall be reserved for small shareholders.

Disclosures, filing requirements and timelines for public announcement:

7. (i) The company which has been authorised by a special resolution or a resolution passed by the board of directors, as the case may be, shall make a public announcement within two working days from the date of declaration of results of the postal ballot for special resolution/board of directors resolution in at least one English National Daily, one Hindi National Daily and one Regional language daily, all with wide circulation at the place where the Registered Office of the company is situated and the said public announcement shall contain all the material information as specified in **Schedule II**.

(ii) A copy of the public announcement along with the soft copy, shall also be submitted to the Board, simultaneously, through a merchant banker.

Disclosures, filing requirements and timelines for draft letter of offer

8. (i) The company shall within five working days of the public announcement file the following with the Board:

(a) a draft letter of offer, along with a soft copy, containing disclosures as specified in Schedule III through a merchant banker who is not associated with the company.

(b) a declaration of solvency in specified form and in a manner provided in sub-section (6) of section 68 of the Companies Act.

(c) fees specified in **Schedule V.**

(ii) The Board may provide its comments on the draft letter of offer not later than seven working days of the receipt of the draft letter of offer:

Provided that in the event the Board has sought clarifications or additional information from the merchant banker to the buy-back offer, the period of issuance of comments shall be extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought:

Provided further that in the event the Board specifies any changes, the merchant banker to the buy-back offer and the company shall carryout such changes in the letter of offer before it is dispatched to the shareholders.

Offer procedure

9. (i) A company making a buy-back offer shall announce a record date in the public announcement for the purpose of determining the entitlement and the names of the security holders, who are eligible to participate in the proposed buy-back offer.

(ii) The letter of offer along with the tender form shall be dispatched to the securities holders who are eligible to participate in the buy-back offer as per sub regulation (i) not later than five working days from the receipt of communication of comments from the Board.

Explanation: (a) Letter of Offer may also be dispatched through electronic mode in accordance with the provisions of the Companies Act.

(b) On receipt of a request from any shareholder to receive a copy of the letter of offer in physical form, the same shall be provided.

(c) The aforesaid shall be disclosed in the letter of offer.

(iii) Even if an eligible public shareholder does not receive the tender Offer /offer form, he may participate in the buy-back offer and tender shares in the manner as provided by the Board.

(iv) An unregistered shareholder may also tender his shares for buy-back by submitting the duly executed transfer deed for transfer of shares in his name, along with the offer form and other relevant documents as required for transfer, if any.

(v) The date of the opening of the offer shall be not later than five working days from the date of dispatch of the letter of offer.

(vi) The offer for buy-back shall remain open for a period of ten working days.

(vii) The company shall facilitate tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism in the manner as provided by the Board.

(viii) The company shall accept shares or other specified securities from the securities holders on the basis of their entitlement as on record date.

(ix) The shares proposed to be bought back shall be divided into two categories; (a) reserved category for small shareholders and (b) the general category for other shareholders, and the entitlement of a shareholder in each category shall be calculated accordingly.

'***Explanation**:* Holdings of multiple demat accounts would be clubbed together for identification of small shareholder if sequence of Permanent Account Number for all holders is matching. Similarly, in case of physical shareholders, if the sequence of names of joint holders is matching, holding under such folios should be clubbed together for identification of small shareholder.

(x) After accepting the shares or other specified securities tendered on the basis of entitlement, shares or other specified securities left to be bought back, if any in one category shall first be accepted, in proportion to the shares or other specified securities tendered over and above their entitlement in the offer by securities holders in that category and thereafter from securities holders who have tendered over and above their entitlement in other category.

(xi) Escrow account

(a) The company shall, as and by way of security for performance of its obligations under the regulations, on or before the opening of the offer, deposit in an escrow account such sum as specified in clause(b);

(b) The escrow amount shall be payable in the following manner:

(i) if the consideration payable does not exceed Rupees 100 crores; 25 per cent of the consideration payable;

(ii) if the consideration payable exceeds Rupees 100 crores; 25 per cent upto Rupees 100 crores and 10 per cent thereafter.

(c) The escrow account referred to in this regulation shall consist of,

(i) cash deposited with a scheduled commercial bank,or

(ii) bank guarantee in favour of the merchant banker,or

(iii) deposit of acceptable securities with appropriate margin, with the merchant banker,or

(iv) a combination of (i), (ii) and(iii).

Explanation: The cash component of the escrow account may be maintained in an interest bearing account, provided that the merchant banker ensures that the funds are available at the time of making payment to shareholders.

(d) Where the escrow account consists of deposit with a scheduled commercial bank, the company shall, while opening the account, empower the merchant banker to instruct the bank to make payment the amount lying to the credit of the escrow account, as provided in the regulations.

(e) Where the escrow account consists of a bank guarantee, such bank guarantee shall be in favour of the merchant banker and shall be valid until thirty days after the expiry of buyback period.

(f) The company shall, in case the escrow account consists of securities, empower the merchant banker to realise the value of such escrow account by sale or otherwise and if there is any deficit on realisation of the value of the securities, the merchant banker shall be liable to make good any such deficit.

(g) In case the escrow account consists of bank guarantee or approved securities, these shall not be returned by the merchant banker till completion of all obligations under the regulations.

(h) Where the escrow account consists of bank guarantee or deposit of approved securities, the company shall also deposit with the bank in cash a sum of at least one per cent of the total consideration payable, as and by way of security for fulfillment of the obligations under the regulations by the company.

(i) On payment of consideration to all the securities holders who have accepted the offer and after completion of all formalities of buy-back, the amount, guarantee and securities in the escrow, if any, shall be released to the company.

(j) The Board in the interest of the securities holders may in case of non fulfillment of obligations under the regulations by the company forfeit the escrow account either in full or in part.

(xii) The amount forfeited under clause (j) may be distributed pro rata amongst the securities holders who accepted the offer and balance, if any, shall be utilised for investor protection.

Closure and payment to securities holders:

10. (i) The company shall immediately after the date of closure of the offer, open a special account with a banker to an issue, registered with the Board and deposit therein, such sum as would, together with ninety per cent of the amount lying in the escrow account, make-up the entire sum due and payable as consideration for buy-back in terms of these regulations and for this purpose, may transfer the funds from the escrow account.

(ii) The company shall complete the verification of offers received and make payment of consideration to those holders of securities whose offer has been accepted and return the remaining shares or other specified securities to the securities holders within seven working days of the closure of the offer.

Extinguishment of certificate and other closure compliances:

11. (i) The company shall extinguish and physically destroy the securities certificates so bought back in the presence of a registrar to issue or the Merchant Banker and the Statutory Auditor within fifteen days of the date of acceptance of the shares or other specified securities.

Provided that the company shall ensure that all the securities bought-back are extinguished within seven days of expiry of buy-back period.

***Explanation*: The aforesaid period of fifteen days shall in no case extend beyond seven days of expiry of buy-back period.

(ii) The shares or other specified securities offered for buy-back if already dematerialised shall be extinguished and destroyed in the manner specified under the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996, and the bye-laws, the circulars and guidelines framed thereunder.

(iii) The company shall, furnish a certificate to the Board certifying compliance as specified in sub-regulation (i) above, and duly certified and verified by:

(a) the registrar and whenever there is no registrar, by the merchant banker;

(b) two directors of the company, one of whom shall be a managing director, where there is one; and

(c) the statutory audit or of the company,

This certificate shall be furnished to the Board within seven days of extinguishment and destruction of the certificates.

(iv) The company shall furnish the particulars of the securities certificates extinguished and destroyed under sub-regulation (i), to the stock exchanges where the shares of the company are listed within seven days of extinguishment and destruction of the certificates.

(v) Where a company buys back its shares or other specified securities under these regulations, it shall maintain a register of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed in sub-section (9) of section 68 of the Companies Act.

Odd-lot buy-back

12. The provisions pertaining to buy-back through tender offer as specified in this Chapter shall be applicable mutatis mutandis to odd-lot shares or other specified securities.

CHAPTER IV

BUY-BACK FROM THE OPEN MARKET

13. A company intending to buy-back its shares or other specified securities from the open market shall do so in accordance with the provisions of this Chapter.

14. The buy-back of shares or other specified securities from the open market may be in any one of the following methods:

(a) through stock exchange,

(b) Book-building process.

15. The company shall ensure that at least fifty per cent of the amount earmarked for buy-back, as specified in the resolution of the board of directors or the special resolution, as the case may be, is utilized for buying-back shares or other specified securities.

Buy-back through stock exchange

16. (i) The buy-back shall be made only on stock exchanges having nationwide trading terminals;

(ii) The buy-back of the shares or other specified securities through the stock exchange shall not be made from the promoters or persons in control of the company;

(iii) The buy-back of shares or other specified securities shall be made only through the order matching mechanism except 'all or none' order matching system;

(iv) Disclosures, filing requirements and timelines of public announcement:

(a) The company shall appoint a merchant banker and make a public announcement as referred to in regulation 7 pertaining to tender offer;

(b) The public announcement shall be made within two working days from the date of passing the board of directors resolution or date of declaration of results of the postal ballot for special resolution, as relevant and shall contain disclosures as specified in **Schedule IV**;

(c) Simultaneously with the issue of such public announcement, the company shall file a copy of the public announcement with the Board along with the fees specified in **Schedule V**;

(d) The public announcement shall also contain disclosures regarding details of the brokers and stock exchanges through which the buy-back of shares or other specified securities would be made;

Explanation: In case of the buy-back from open market, no draft letter of offer/ letter of offer are required to be filed with the Board.

Opening of the offer on stock exchange:

17. (i) The identity of the company as a purchaser shall appear on the electronic screen when the order is placed;

(ii) The buy-back offer shall open not later than seven working days from the date of public announcement and shall close within six months from the date of opening of the offer.

Subsequent compliances for open market buy-back through stock exchange:

18. (i) The company shall submit the information regarding the shares or other specified securities bought-back, to the stock exchange on a daily basis in such form as may be specified by the Board and the stock exchange shall upload the same on its official website immediately;

(ii) The company shall upload the information regarding the shares or other specified securities bought-back on its website on a daily basis.

19. A company may buy-back its shares or other specified securities in physical form in the open market through stock exchange by following the procedure as provided here under:

(i) A separate window shall be created by the stock exchange, which shall remain open during the period of buy-back, for buy-back of shares or other specified securities in physical form.

(ii) The company shall buy-back shares or other specified securities from eligible shareholders holding physical shares through the separate window specified in sub-regulation (i), only after verification of the identity proof and address proof by the broker.

(iii) The price at which the shares or other specified securities are bought back shall be the volume weighted average price of the shares or other specified securities bought-back, other than in the physical form, during the calendar week in which such shares or other specified securities were received by the broker:

Provided that the price of shares or other specified securities tendered during the first calendar week of the buy-back shall be the volume weighted average market price of the shares or other specified securities of the company during the preceding calendar week.

Explanation: In case no shares or other specified securities were bought back in the normal market during calendar week, the preceding week when the company has last bought back the shares or other specified securities may be considered.

Escrow account for open market buy-back through stock exchange:

20. (i) The company shall, before opening of the offer, create an escrow account towards security for performance of its obligations under these regulations, and deposit in escrow account 25 per cent of the amount earmarked for the buy-back as specified in the resolution of the board of directors or the special resolution, as the case maybe.

(ii) The escrow account referred to in sub-regulation (i) may be in the form of,—

(a) cash deposited with any scheduled commercial bank; or

(b) bank guarantee issued in favour of the merchant banker by any scheduled commercial bank.

Explanation: The cash component of the escrow account may be maintained in terms of Explanation to clause (c) of sub-regulation (xi) of regulation 9.

(iii) For such part of the escrow account as is in the form of a cash deposit with a scheduled commercial bank, the company shall while opening the account, empower the merchant banker to instruct the bank to make payment of the amounts lying to the credit of the escrow account, to meet the obligations arising out of the buy-back.

(iv) For such part of the escrow account as is in the form of a bank guarantee:

(a) the same shall be in favour of the merchant banker and shall be kept valid for a period of thirty days after the expiry of buyback period of the offer or till the completion of all obligations under these regulations, whichever is later.

(b) the same shall not be returned by the merchant banker till completion of all obligations under there regulations.

(v) Where part of the escrow account is in the form of a bank guarantee, the company shall deposit with a scheduled commercial bank, in cash ,a sum of at least 2.5 per cent of the total amount earmarked for buy-back as specified in the resolution of the board of directors or the special resolution, as the case may be, as and by way of security for fulfillment of the obligations under the regulations by the company.

(vi) The escrow amount may be released for making payment to the shareholders subject to at least 2.5 per cent of the amount earmarked for buy- back as specified in the resolution of the board of directors or the special resolution, as the case may be, remaining in the escrow account at all points of time.

(vii) On fulfilling the obligation specified in regulation 15, the amount and the guarantee remaining in the escrow account, if any, shall be released to the company.

(viii) In the event of non-compliance with regulation 15, the Board may direct the merchant banker to forfeit these escrow account ,subject to a maximum of 2.5 per cent of the amount earmarked for buy-back as specified in the resolution of the board of directors or the special resolution, as the case may be, except in cases where,-

(a) volume weighted average market price (VWAMP) of the shares or other specified securities of the company during the buy-back period was higher than the buy-back price as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

(b) sell orders were inadequate despite the buy orders placed by the company as certified by the Merchant banker based on the inputs provided by the Stock Exchanges.

(c) such circumstances existed which were beyond the control of the company and in the opinion of the Board merit consideration.

(ix) In the event of forfeiture for non-fulfillment of obligations specified in sub-regulation (viii) of this regulation ,the amount forfeited shall be deposited in the Investor Protection and Education Fund of Securities and Exchange Board of India.

Extinguishment of certificates for open market buy-back through stock exchange:

21. (i) Subject to the provisions of sub-regulation (ii) and (iii), the provisions of regulation 11 pertaining to the extinguishment of certificates for tender offers shall apply for extinguishment of certificates under this Chapter.

(ii) The company shall complete the verification of acceptances within fifteen days of the payout.

(iii) The company shall extinguish and physically destroy the securities certificates so bought back during the month in the presence of a Merchant Banker and the Statutory Auditor, on or before the fifteenth day of the succeeding month:

Provided that the company shall ensure that all the securities bought-back are extinguished within seven days of expiry of buy-back period.

Buy-back through book building

22. A company may buy-back its shares or other specified securities through the book-building process as provided hereunder:

(i) The Special resolution or the board of directors resolution, as the case may be, shall be passed in accordance with regulation5.

(ii) Disclosures, filing requirements and timelines for public announcement:

(a) The company shall appoint a merchant banker and make a public announcement as referred to in regulation7.

(b) The disclosures in the public announcement shall also be in accordance with Schedule II.

(c) The public announcement shall be made at least seven days prior to the commencement of buy-back.

(iii) Subject to the provisions of clause (a) and clause (b) of this sub- regulation, the provisions of sub-regulation (xi) of regulation 9 shall apply:

(a) The deposit in the escrow account shall be made before the date of the public announcement.

(b) The amount to be deposited in the escrow account shall be determined with reference to the maximum price as specified in the public announcement.

Explanation: The cash component of the escrow account may be maintained in terms of the Explanation to clause (c) of sub-regulation (xi) of regulation9.

(iv) A copy of the public announcement shall be filed with the Board within two days of such announcement along with the fees as specified in **Schedule V**.

(v) The public announcement shall also contain the detailed methodology of the book-building process, the manner of acceptance, the format of acceptance to be sent by the securities holders pursuant to the public announcement and the details of bidding centers.

(vi) The book-building process shall be made through an electronically linked transparent facility.

(vii) The number of bidding centers shall not be less than thirty and there shall be at least one electronically linked computer terminal at all the bidding centers.

(viii) The offer for buy-back shall remain open to the securities holders for a period not less than fifteen days and not exceeding thirty days.

(ix) The merchant banker and the company shall determine the buy-back price based on the acceptances received.

(x) The final buy-back price, which shall be the highest price accepted shall be paid to all holders whose shares or other specified securities have been accepted for buy-back.

(xi) The provisions of sub-regulation (ii) of regulation 10 pertaining to verification of acceptances and the provisions of regulation 10 pertaining to opening of special account and payment of consideration shall be applicable mutatis mutandis.

Extinguishment of certificates

23. The provisions pertaining to extinguishment of certificates for tender offer shall be applicable mutatis mutandis to the buy-back through book building.

CHAPTER V

GENERAL OBLIGATIONS

Obligations of the company for all buy-back procedure:

24. (i) The company shall ensure that,—

(a) the letter of offer, the public announcement of the offer or any other advertisement, circular, brochure, publicity material shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

(b) the company shall not issue any shares or other specified securities including by way of bonus till the date of expiry of buyback period for the offer made under these regulations;

(c) the company shall pay the consideration only by way of cash;

(d) the company shall not withdraw the offer to buy-back after the draft letter of offer is filed with the Board or public announcement of the offer to buy-back is made;

(e) the promoter(s) or his/their associates shall not deal in the shares or other specified securities of the company in the stock exchange or off-market, including inter- se transfer of shares among the promoters during the period from the date of passing the resolution of the board of directors or the special resolution, as the case may be, till the closing of the offer.

(f) the company shall not raise further capital for a period of one year from the expiry of buyback period, except in discharge of its subsisting obligations.

(ii) No public announcement of buy-back shall be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act.

(iii) The company shall nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors.

(iv) The particulars of the security certificates extinguished and destroyed shall be furnished by the company to the stock exchanges where the shares or other specified securities of the company are listed within seven days of extinguishment and destruction of the certificates.

(v) The company shall not buy-back the locked-in shares or other specified securities and non-transferable shares or other specified securities till the pendency of the lock-in or till the shares or other specified securities become transferable.

(vi) The company shall within two days of expiry of buy-back period issue a public advertisement in a national daily, inter alia disclosing:

(a) number of shares or other specified securities bought;

(b) price at which the shares or other specified securities bought;

(c) total amount invested in the buy-back;

(d) details of the securities holders from whom shares or other specified securities exceeding one per cent of total shares or other specified securities were bought back; and

(e) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

(vii) The company in addition to these regulations shall comply with the provisions of buy-back as contained in the Companies Act and other applicable laws.

Obligations of the merchant banker:

25. The merchant banker shall ensure that—

(i) the company is able to implement the offer;

(ii) the provision relating to escrow account has been complied with;

(iii) firm arrangements for monies for payment to fulfill the obligations under the offer are in place;

(iv) the public announcement of buy-back is made in terms of the regulations;

(v) the letter of offer has been filed in terms of the regulations;

(vi) a due diligence certificate along with the draft letter of offer has been furnished to the Board;

(vii) the contents of the public announcement of offer as well as the

(viii) letter of offer are true, fair and adequate and quoting the source wherever necessary;

(ix) due compliance of sections 68, 69 and 70 of the Companies Act and any other laws or rules as may be applicable in this regard has been made;

(x) the bank with whom the escrow or special amount has been deposited releases the balance amount to the company only upon fulfillment of all obligations by the company under the regulations;

(xi) a final report is submitted to the Board in the form specified within fifteen days from the date of expiry of buyback period.

CHAPTER VI

MISCELLANEOUS

Powers of the Board to issue directions

26. (i) The Board may, without prejudice to its right to initiate any other enforcement action, including prosecution under section 24 of the Act, give such directions in the interest of investors in securities and the securities market, as it deems fit including:

(a) prohibiting the person concerned from cancelling any of the securities bought back in violation of the provisions of these regulations or the Companies Act;

(b) directing the person concerned to sell or divest the shares or other specified securities acquired in violation of the provisions of these regulations or any other law or regulations;

(c) restraining the company from making a further offer for buy-back;

(ii) A copy of such direction issued by the Board shall also be forwarded to Registrar of Companies.

Power of the Board to remove difficulties

27. In order to remove any difficulties in the interpretation or application of the provisions of these regulations, the Board may issue clarifications or guidelines from time to time.

Power to relax strict enforcement of the regulations.

28. (i) The Board may, in the interest of investors and the securities market, relax the strict enforcement of any requirement of these regulations except the provisions incorporated from the Companies Act, if the Board is satisfied that:

(a) the requirement is procedural in nature or

(b) the requirement may cause undue hardship to investors;

(ii) For seeking relaxation under sub-regulation (i), the company shall file an application with the Board, supported by a duly sworn affidavit; giving details and the grounds on which such relaxation has been sought.

(iii) The company shall along with the application referred to under sub-regulation (ii), pay a non-refundable fee of rupees fifty thousand, by way of direct credit in the bank account through NEFT/RTGS/IMPS or any other mode allowed by RBI or by way of a banker's cheque or demand draft payable in Mumbai in favour of the Board.

(iv) The Board may after affording reasonable opportunity of being heard to the applicant and after considering all the relevant facts and circumstances, pass a reasoned order either granting or rejecting the relaxation sought as expeditiously as possible.

Repeal and savings

29. (i) The Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 1998, shall stand repealed from the date on which these regulations come into force.

(ii) Notwithstanding such repeal,—

(a) anything done or any action taken or purported to have been done or taken including comments on any letter of offer, exemption granted by the Board, fees collected, any adjudication, enquiry or investigation commenced or show-cause notice issued under the repealed regulations, prior to such repeal, shall be deemed to have been done or taken under the corresponding provisions of these regulations;

(b) the previous operation of the repealed regulations or anything duly done or suffered there under, any right, privilege, obligation or liability acquired, accrued or incurred under the repealed regulations, any penalty, forfeiture or punishment incurred in respect of any violation committed against the repealed regulations, or any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid, shall remain unaffected as if the repealed regulations has never been repealed;

(c) any buy-back offer for which a public announcement has been made under the repealed regulations shall be required to be continued and completed under the repealed regulations.

(iii) After the repeal of Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 1998, any reference thereto in any other regulations made, guidelines or circulars issued thereunder by the Board shall be deemed to be a reference made to the corresponding provisions of these regulations.

CHAPTER 5

SEBI (MUTUAL FUNDS) REGULATIONS, 1996

CHAPTER I

PRELIMINARY

Short title, application and commencement

1. (1) These regulations maybe called the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

(2) They shall come into force on the date of their publication in the Official Gazette.

Definitions

2. In these regulations, unless the context otherwise requires:—

(a) "Act" means the Securities and Exchange Board of India Act, 1992 (15 of1992);

(b) "advertisement" shall include all forms of communication issued by or on behalf of the asset management company/mutual fund that may influence investment decisions of any investor/prospective investors;

(c) "associate" includes a person,—

(i) who directly or indirectly, by himself ,or in combination with relatives ,exercises control over the asset management company or the trustee, as the case may be, or

(ii) in respect of whom the asset management company or the trustee, directly or indirectly, by itself, or in combination with other persons exercises a control, or

(iii) whose director, officer or employee is a director, officer or employee of the asset management company; "asset management company" means a company formed and registered under the companies

(d) "asset management company" means a company formed and registered under the Companies Act, 1956 (1 of 1956) and approved as such by the Board under sub regulation (2) of regulation 21;

(e) "broker" means a stock broker as defined in Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Rules, 1992;

(ea) "capital protection oriented scheme" means a mutual fund scheme which is designated as such and, which endeavor's to protect the capital invested therein through suitable orientation of its portfolio structure;

(f) "close-ended scheme" means any scheme of a mutual fund in which the period of maturity of the scheme is specified;

(g) "control" means,—

(i) in the case of a company any person or combination of persons who directly or indirectly own, control or hold shares carrying not less than 10% of the voting rights of such company; or

(ii) as between two companies, if the same person or combination of persons directly or indirectly, own, control or hold shares carrying not less than 10% of the voting rights of each of the two companies; or

(iii) majority of the directors of any company who are in a position to exercise control over the asset management company;

(h) "custodian" means a person who has been granted a certificate of registration to carry on the business of custodian of securities under the Securities and Exchange Board of India (Custodian of Securities) Regulations, 1996;

(i)"depository" means a body corporate as defined in the Depositories Act, 1996 (22 of 1996);

(j) "economic offence" means an offence to which the Economic Offences (Limitation of Prosecution) Act, 1974 (12 of 1974), applies for the time being;

(k) omitted

(l) "form" means any of the forms specified as such in the First Schedule;

(m) "fraud" for the purpose of these regulations has the same meaning as is assigned to it in section 17 of the Indian Contract Act, 1872 (9 of 1872);

(ma) "fund of funds scheme" means a mutual fund scheme that invests primarily in other schemes of the same mutual fund or other mutual funds;

(mb) "gold exchange traded fund scheme" shall mean a mutual fund scheme that invests primarily in gold or gold related instruments;

(mc) “gold related instrument” shall mean such instrument having gold as underlying, as may be specified by the Board from time to time;

(md) goods” means the goods notified by the Central Government under clause (bc) of section 2 of the Securities Contracts (Regulation) Act, 1956 and forming the underlying of any commodity derivative;

(mm) “group” means a group as defined in clause (ef) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969);

(mn) “index fund scheme” means a mutual fund scheme that invests in securities in the same proportion as an index of securities;

(mo) “InvIT” or “Infrastructure Investment Trust” shall have the meaning assigned in clause (za) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014;

(n) “inspecting officer” means any person appointed as such by the Board under Chapter VIII;

(o) “money market instruments” includes commercial papers, commercial bills, treasury bills, Government securities having an unexpired maturity up to one year, call or notice money, certificate of deposit, usance bills, and any other like instruments as specified by the Reserve Bank of India from time to time;

(p) “money market mutual fund” means a scheme of a mutual fund which has been set up with the objective of investing exclusively in money market instruments;

(q) “mutual fund” means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments or real estate assets;

(r) “offer document” means any document by which a mutual fund invites public for subscription of units of a scheme;

(s) “open-ended scheme” means a scheme of a mutual fund which offers units for sale without specifying any duration for redemption;

(sa) "private placement" means any offer of units of a mutual fund scheme or invitation to subscribe such units to a select group of persons, by a mutual fund (other than by way of public offer) through issue of a placement memorandum and which is not being calculated to result, directly or indirectly in the units becoming available for subscription or purchase by persons other than those receiving the offer or invitation;

(sb) “REIT” or “Real Estate Investment Trust” shall have the meaning assigned in clause (zm) of sub-regulation 1 of regulation 2 of the Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014;

(sc) “real estate mutual fund scheme” means a mutual fund scheme that invests directly or indirectly in real estate assets or other permissible assets in accordance with these regulations;

(t) “relative” means a person as defined in section 6 of the Companies Act, 1956 (1 of 1956);

(u) “scheme” means a scheme of a mutual fund launched under Chapter V;

(v) “schedule” means any of the schedules annexed to these regulations;

(w) “securities laws” means the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and the Depositories Act, 1996 (22 of 1996), including their amendments and such other laws as may be enacted from time to time;

(x) “sponsor” means any person who, acting alone or in combination with another body corporate, establishes a mutual fund;

(y) “trustees” mean the Board of Trustees or the Trustee Company who hold the property of the Mutual Fund in trust for the benefit of the unit holders;

(z) “unit” means the interest of the unit holders in a scheme, which consists of each unit representing one undivided share in the assets of a scheme;

(z)(i) “unit holder” means a person holding unit in a scheme of a mutual fund.

CHAPTER II

REGISTRATION OF MUTUAL FUND

Application for registration

3. An application for registration of a mutual fund shall be made to the Board in Form A by the sponsor.

Application fee to accompany the application

4. Every application for registration under regulation 3 shall be accompanied by nonrefundable application fee as specified in the Second Schedule. Application to conform to the requirements

Application to conform to the requirements

5. An application, which is not complete in all respects shall be liable to be rejected:

Provided that, before rejecting any such application, the applicant shall be given an opportunity to complete such formalities within such time as may be specified by the Board.

Furnishing information

6. The Board may require the sponsor to furnish such further information or clarification as may be required by it.

Eligibility criteria

7. For the purpose of grant of a certificate of registration, the applicant has to fulfill the following, namely—

(a) the sponsor should have a sound track record and general reputation of fairness and integrity in all his business transactions.

Explanation: For the purposes of this clause "sound track record" shall mean the sponsor should—

(I) be carrying on business in financial services for a period of not less than five years; and

(II) the net worth is positive in all the immediately preceding five years; and

(III) the net worth in the immediately preceding year is more than the capital contribution of the sponsor in the asset management company; and

(IV) the sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year;

(aa) the applicant is a fit and proper person;

(b) in the case of an existing mutual fund, such fund is in the form of a trust and the trust deed has been approved by the Board;

(c) the sponsor has contributed or contributes at least 40% to the net worth of the asset management company:

Provided that any person who holds 40% or more of the net worth of an asset management company shall be deemed to be a sponsor and will be required to fulfill the eligibility criteria specified in these regulations;

(d) the sponsor or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence;

(e) appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations;

(f) appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations;

(g) appointment of custodian in order to keep custody of the securities or goods or gold and gold related instrument or other assets of the mutual fund held in terms of these regulations, and provide such other custodial services as may be authorised by the trustees.

Criteria for fit and proper person

7A. For the purpose of determining whether an applicant or the mutual fund is a fit and proper person the Board may take into account the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Norms for Shareholding and Governance in Mutual Funds

7B. (1) No sponsor of a mutual fund, its associate or group company including the asset management company of the fund, through the schemes of the mutual fund or otherwise, individually or collectively, directly or indirectly, have –

(a) 10% or more of the share-holding or voting rights in the asset management company or the trustee company of any other mutual fund; or

(b) representation on the board of the asset management company or the trustee company of any other mutual fund.

(2) Any shareholder holding 10% or more of the share-holding or voting rights in the asset management company or the trustee company of a mutual fund, shall not have, directly or indirectly, -

(a) 10% or more of the share-holding or voting rights in the asset management company or the trustee company of any other mutual fund; or

(b) representation on the board of the asset management company or the trustee company of any other mutual fund.

(3) Any person not in conformity with the sub-regulations (1) and (2) of this regulation, as on the date of the coming into force of this regulation shall comply with sub-regulations (1) and (2) within a period of one year from the date of the coming into force of this regulation:

Provided that in the event of a merger, acquisition, scheme of arrangement or any other arrangement involving the sponsors of the mutual funds, shareholders of the asset management companies or trustee companies, their associates or group companies which results in the incidental acquisition of shares, voting rights or representation on the board of the asset management companies or trustee companies, this regulation shall be complied with within a period of one year of coming into force of such an arrangement.

Consideration of application

8. The Board, may on receipt of all information decide the application.

Grant of Certificate of Registration

9. The Board may register the mutual fund and grant a certificate in Form B on the applicant paying the registration fee as specified in Second Schedule.

Terms and conditions of registration

10. The registration granted to a mutual fund under regulation 9, shall be subject to the following terms and conditions—

(a) the trustees, the sponsor, the asset management company and the custodian shall comply with the provisions of these regulations;

(b) the mutual fund shall forthwith inform the Board, if any information or particulars previously submitted to the Board was misleading or false in any material respect;

(c) the mutual fund shall forthwith inform the Board, of any material change in the information or particulars previously furnished, which have a bearing on the registration granted by it;

(d) payment of fees as specified in the regulations and the Second Schedule.

Rejection of application

11. Where the sponsor does not satisfy the eligibility criteria mentioned in regulation 7, the Board may reject the application and inform the applicant of the same.

Payment of annual service fee

12. A mutual fund shall pay before the 15th April each year a service fee as specified in the Second Schedule for every financial year from the year following the year of registration:

Provided that the Board may, on being satisfied with the reasons for the delay permit the mutual fund to pay the service fee at any time before the expiry of two months from the commencement of the financial year to which such fee relates.

Failure to pay annual service fee

13. The Board may not permit a mutual fund who has not paid service fee to launch any scheme.

CHAPTER III

CONSTITUTION AND MANAGEMENT OF MUTUAL FUND AND OPERATION OF TRUSTEES, ETC

Trust deed to be registered under the Registration Act

14. A mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed, duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908), executed by the sponsor in favour of the trustees named in such an instrument.

Contents of trust deed

15. (1) The trust deed shall contain such clauses as are mentioned in the Third Schedule and such other clauses which are necessary for safeguarding the interests of the unit holders.

(2) No trust deed shall contain a clause which has the effect of—

(i) limiting or extinguishing the obligations and liabilities of the trust in relation to any mutual fund or the unit holders; or

(ii) Indemnifying the trustees or the asset management company for loss or damage caused to the unit holders by their acts of negligence or acts of commission or omission.

Disqualification from being appointed as trustees

16. (1) A mutual fund shall appoint trustees in accordance with these regulations.

(2) No person shall be eligible to be appointed as a trustee unless—

(a) he is a person of ability, integrity and standing; and

(b) has not been found guilty of moral turpitude; and

(c) has not been convicted of any economic offence or violation of any securities laws; and

(d) has furnished particulars as specified in Form C.

(3) No asset management company and no director (including independent director), officer or employee of an asset management company shall be eligible to be appointed as a trustee of any mutual fund.

(4) No person who is appointed as a trustee of a mutual fund shall be eligible to be appointed as a trustee of any other mutual fund:

Provided that any mutual fund which is not in compliance with sub-regulation (3) or (4) as at the commencement of the Securities and Exchange Board of India (Mutual Funds) (Fifth Amendment) Regulations, 2006 shall ensure compliance therewith within three months from such commencement.

(5) Two-thirds of the trustees shall be independent persons and shall not be associated with the sponsors or be associated with them in any manner whatsoever.

(6) In case a company is appointed as a trustee then its directors can act as trustees of any other trust provided that the object of the trust is not in conflict with the object of the mutual fund.

Approval of the Board for appointment of trustee

17. (1) No trustee shall initially or any time thereafter be appointed without prior approval of the Board.

(2) The existing trustees of any mutual fund may form a trustee company to act as a trustee with the prior approval of the Board.

Rights and obligations of the trustees

18. (1) The trustees and the asset management company shall with the prior approval of the Board enter into an investment management agreement.

(2) The investment management agreement shall contain such clauses as are mentioned in the Fourth Schedule and such other clauses as are necessary for the purpose of making investments.

(3) The trustees shall have a right to obtain from the asset management company such information as is considered necessary by the trustees.

(4) The trustees shall ensure before the launch of any scheme that the asset management company, has,—

(a) systems in place for its back office, dealing room and accounting;

(b) appointed all key personnel including fund manager(s) for the scheme(s) and submitted their bio-data which shall contain the educational qualifications, past experience in the securities market with the trustees, within 15 days of their appointment;

(c) appointed auditors to audit its accounts;

(d) appointed a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors grievances;

(e) appointed registrars and laid down parameters for their supervision;

(f) prepared a compliance manual and designed internal control mechanisms including internal audit systems;

(g) specified norms for empanelment of brokers and marketing agents;

(h) obtained, wherever required under these regulations, prior in principle approval from the recognised stock exchange(s) where units are proposed to be listed.

(4A) The compliance officer appointed under clause (d) of sub-regulation (4) shall immediately and independently report to the Board any non-compliance observed by him.

(5) The trustees shall ensure that an asset management company has been diligent in empanelling the brokers, in monitoring securities transactions with brokers and avoiding undue concentration of business with any broker.

(6) The trustees shall ensure that the asset management company has not given any undue or unfair advantage to any associates or dealt with any of the associates of the asset management company in any manner detrimental to interest of the unit holders.

(7) The trustees shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme.

(8) The trustees shall ensure that the asset management company has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of investors of one scheme are not being compromised with those of any other scheme or

of other activities of the asset management company.

(9) The trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations.

(10) Where the trustees have reason to believe that the conduct of business of the mutual fund is not in accordance with these regulations and the scheme they shall forthwith take such remedial steps as are necessary by them and shall immediately inform the Board of the violation and the action taken by them.

(11) Each trustee shall file the details of his transactions of dealing in securities with the Mutual Fund on a quarterly basis.

(12) The trustees shall be accountable for, and be the custodian of, the funds and property of the respective schemes and shall hold the same in trust for the benefit of the unit holders in accordance with these regulations and the provisions of trust deed.

(13) The trustees shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed.

(14) The trustees shall be responsible for the calculation of any income due to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the units of any scheme in accordance with these regulations and the trust deed.

(15) The trustees shall obtain the consent of the unit holders—

(a) whenever required to do so by the Board in the interest of the unit holders; or

(b) whenever required to do so on the requisition made by three-fourths of the unit- holders of any scheme; or

(c) when the majority of the trustees decide to wind up or prematurely redeem the units.

(15A) The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unit holders, shall be carried out unless,—

(i) a written communication about the proposed change is sent to each unit holder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of region where the Head Office of the mutual fund is situated; and

(ii) the unit holders are given an option to exit at the prevailing Net Asset Value without any exit load.

(16) The trustees shall call for the details of transactions in securities by the key personnel of the asset management company in his own name or on behalf of the asset management company and shall report to the Board, as and when required.

(17) The trustees shall quarterly review all transactions carried out between the mutual funds, asset management company and its associates.

(18) The trustees shall quarterly review the net worth of the asset management company and in case of any shortfall, ensure that the asset management company make up for the shortfall as per clause (f) of sub-regulation (1) of regulation 21.

(19) The trustees shall periodically review all service contracts such as custody arrangements, transfer agency of the securities and satisfy itself that such contracts are executed in the interest of the unit holder.

(20) The trustees shall ensure that there is no conflict of interest between the manner of deployment of its net worth by the asset management company and the interest of the unit-holders.

(21) The trustees shall periodically review the investor complaints received and the redressal of the same by the asset management company.

(22) The trustees shall abide by the Code of Conduct as specified in the Fifth Schedule.

(23) The trustees shall furnish to the Board on a half-yearly basis,—

(a) a report on the activities of the mutual fund;

(b) a certificate stating that the trustees have satisfied themselves that there have been no instances of self-dealing or front running by any of the trustees, directors and key personnel of the asset management company;

(c) a certificate to the effect that the asset management company has been managing the schemes independently of any other activities and in case any activities of the nature referred to in sub-regulation (2) of regulation 24 have been undertaken by the asset management company and has taken adequate steps to ensure that the interests of the unit holders are protected.

(24) The independent trustees referred to in sub-regulation (5) of regulation 16 shall give their comments on the report received from the asset management company regarding the investments by the mutual fund in the securities of group companies of the sponsor.

(25) Trustees shall exercise due diligence as under:

A. General Due Diligence:

(i) The Trustees shall be discerning in the appointment of the directors on the Board of the asset management company.

(ii) Trustees shall review the desirability or continuance of the asset management company if substantial irregularities are observed in any of the schemes and shall not allow the asset management company to float new schemes.

(iii) The Trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.

(iv) The Trustee shall ensure that all service providers are holding appropriate registrations from the Board or concerned regulatory authority.

(v) The Trustees shall arrange for test checks of service contracts.

(vi) Trustees shall immediately report to the Board of any special developments in the mutual fund.

B. Specific due diligence: The Trustees shall:

(i) obtain internal audit reports at regular intervals from independent auditors appointed by the Trustees,

(ii) obtain compliance certificates at regular intervals from the asset management company,

(iii) hold meeting of trustees more frequently,

(iv) consider the reports of the independent auditor and compliance reports of asset management company at the meetings of trustees for appropriate action,

(v) maintain records of the decisions of the Trustees at their meetings and of the minutes of the meetings,

(vi) prescribe and adhere to a code of ethics by the Trustees, asset management company and its personnel,

(vii) communicate in writing to the asset management company of the deficiencies and checking on the rectification of deficiencies.

(26) Notwithstanding anything contained in sub-regulations (1) to (25), the trustees shall not be held liable for acts done in good faith if they have exercised adequate due diligence honestly.

(27) The independent directors of the trustees or asset management company shall pay specific attention to the following, as may be applicable, namely:—

(i) the Investment Management Agreement and the compensation paid under the agreement,

(ii) service contracts with affiliates—whether the asset management company has charged higher fees than outside contractors for the same services,

(iii) selections of the asset management company's independent directors,

(iv) securities transactions involving affiliates to the extent such transactions are permitted,

(v) selecting and nominating individuals to fill independent directors vacancies,

(vi) code of ethics must be designed to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions,

(vii) the reasonableness of fees paid to sponsors, asset management company and any others for services provided,

(viii) principal underwriting contracts and their renewals,

(ix) any service contract with the associates of the asset management company.

CHAPTER IV

CONSTITUTION AND MANAGEMENT OF ASSET MANAGEMENT COMPANY AND CUSTODIAN

Application by an asset management company

19. (1) The application for the approval of the asset management company shall be made in Form D.

(2) The provisions of regulations 5, 6 and 8 shall, so far as may be, apply to the application made under sub-regulation (1) as they apply to the application for registration of a mutual fund.

Appointment of an asset management company

20. (1) The sponsor or, if so authorised by the trust deed, the trustee, shall appoint an asset management company, which has been approved by the Board under sub-regulation (2) of regulation 21.

(2) The appointment of an asset management company can be terminated by majority of the trustees or by seventy-five per cent of the unit holders of the scheme.

(3) Any change in the appointment of the asset management company shall be subject to prior approval of the Board and the unit holders.

Eligibility criteria for appointment of asset management company

21. (1) For grant of approval of the asset management company the applicant has to fulfill the following :—

(a) in case the asset management company is an existing asset management company it has a sound track record, general reputation and fairness in transactions.

Explanation: For the purpose of this clause sound track record shall mean the net worth and the profitability of the asset management company;

(aa) the asset management company is a fit and proper person;

(b) the directors of the asset management company are persons having adequate professional experience in finance and financial services related field and not found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws;

(c) the key personnel of the asset management company have not been found guilty of moral turpitude or convicted of economic offence or violation of securities laws or worked for any asset management company or mutual fund or any intermediary during the period when its registration has been suspended or cancelled at any time by the Board;

(d) the board of directors of such asset management company has at least fifty per cent directors, who are not associate of, or associated in any manner with, the sponsor or any of its subsidiaries or the trustees;

(e) the Chairman of the asset management company is not a trustee of any mutual fund;

(f) the asset management company has a net worth of not less than rupees fifty crore:

Provided that an asset management company already granted approval under the provisions of Securities and Exchange Board of India (Mutual Funds) Regulations,1996 shall within a period of three years from the date of notification of Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2014 increase its net worth to rupees fifty crore:

Provided further that no new schemes shall be allowed to be launched or managed by such asset management company till the net worth has been raised to rupees fifty crore.

Explanation: For the purposes of this clause, “net worth” means the aggregate of the paid up capital and free reserves of the asset management company after deducting therefrom miscellaneous expenditure to the extent not written off or adjusted or deferred revenue expenditure, intangible assets and accumulated losses.

Provided further that an asset management company of a mutual fund eligible to launch only infrastructure debt fund schemes, shall have a net worth of not less than rupees ten crore.

Provided further that in cases where the Board is satisfied that an asset management company is taking steps to meet the net worth requirement within the specified time, the asset management company may be allowed to launch up to two new schemes per year.

Explanation: For the purposes of this clause, "net worth" means the aggregate of the paid up capital and free reserves of the asset management company after deducting there from miscellaneous expenditure to the extent not written off or adjusted or deferred revenue expenditure, intangible assets and accumulated losses.

(2) The Board may, after considering an application with reference to the matters specified in sub-regulation (1), grant approval to the asset management company.

Terms and conditions to be complied with

22. The approval granted under sub-regulation (2) of regulation 21 shall be subject to the following conditions, namely :—

(a) any director of the asset management company shall not hold the office of the director in another asset management company unless such person is an independent director referred to in clause (d) of sub-regulation (1) of regulation 21 and approval of the Board of asset management company of which such person is a director, has been obtained;

(b) the asset management company shall forthwith inform the Board of any material change in the information or particulars previously furnished, which have a bearing on the approval granted by it;

(c) no appointment of a director of an asset management company shall be made without prior approval of the trustees;

(d) the asset management company undertakes to comply with these regulations;

(e) no change in the controlling interest of the asset management company shall be made unless,—

(i) prior approval of the trustees and the Board is obtained;

(ii) a written communication about the proposed change is sent to each unit holder and an advertisement is given in one English daily newspaper having nationwide circulation and in a newspaper published in the language of the region where the Head Office of the mutual fund is situated; and

(iii) the unit holders are given an option to exit on the prevailing Net Asset Value without any exit load;

(f) the asset management company shall furnish such information and documents to the trustees as and when required by the trustees.

Procedure where approval is not granted

23. Where an application made under regulation 19 for grant of approval does not satisfy the eligibility criteria laid down in regulation 21, the Board may reject the application.

Restrictions on business activities of the asset management company

24. The asset management company shall, -

(a) not act as a trustee of any mutual fund;

(b) not undertake any business activities other than in the nature of management and advisory services provided to pooled assets including offshore funds, insurance funds, pension funds, provident funds, or Category I foreign portfolio investor as specified in Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, if any of such activities are not in conflict with the activities of the mutual fund:

Provided that the asset management company may itself or through its subsidiaries undertake such activities, as permitted under clause (b), if, -

(i) it satisfies the Board that bank and securities accounts are segregated activity wise;

(ii) it meets with the capital adequacy requirements, if any, separately for each such activity and obtain separate approval, if necessary under the relevant regulations;

(iii) it ensures that there is no material conflict of interest across different activities;

(iv) the absence of conflict of interest shall be disclosed to the trustees and unit holders in scheme information document and statement of additional information;

(v) there are unavoidable conflict of interest situations, it shall satisfy itself that disclosures are made of source of conflict, potential 'material risk or damage' to investor interests and detailed parameters for the same;

(vi) it appoints separate fund manager for each separate fund managed by it unless the investment objectives and asset allocation are same and the portfolio is replicated across all the funds managed by the fund manager, within a period of six months from the date of notification of Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011;

Provided that the requirements of this clause shall not apply if the funds managed are of Category I foreign portfolio investors and/or Category II foreign portfolio investors which are appropriately regulated broad based funds, as specified in Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014

(vii) it ensures fair treatment of investors across different products that shall include, but not limited to, simultaneous buy and sell in the same equity security only through market mechanism and a written trade order management system; and

(viii) it ensures independence to key personnel handling the relevant conflict of interest is provided through removal of direct link between remuneration to relevant asset management company personnel and revenues generated by that activity:

Provided further that the asset management company may, itself or through its subsidiaries, undertake portfolio management services and advisory services for other than broad based fund till further directions, as may be specified by the Board, subject to compliance with the following additional conditions:-

(i) it satisfies the Board that key personnel of the asset management company, the system, back office, bank and securities accounts are segregated activity wise and there exist system to prohibit access to inside information of various activities;

(ii) it meets with the capital adequacy requirements, if any, separately for each of such activities and obtain separate approval, if necessary under the relevant regulations.

Provided further that the asset management company may become a proprietary trading member for carrying out trades in the debt segment of a recognised stock exchange, on behalf of a mutual fund.

Explanation: — For the purpose of this regulation, with the exception of proviso to clause (vi) of first proviso to clause (b), the term 'broad based fund' shall mean the fund which has at least twenty investors and no single investor account for more than twenty five percent of corpus of the fund.

Asset Management Company and its obligations

25. (1) The asset management company shall take all reasonable steps and exercise due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provisions of these regulations and the trust deed.

(2) The asset management company shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business.

(2A) The asset management company shall obtain, wherever required under these regulations, prior in-principle approval from the recognized stock exchange(s) where units are proposed to be listed.

(3) The asset management company shall be responsible for the acts of commission or omission by its employees or the persons whose services have been procured by the asset management company.

(4) The asset management company shall submit to the trustees quarterly reports of each year on its activities and the compliance with these regulations.

(5) The trustees at the request of the asset management company may terminate the assignment of the asset management company at any time:

Provided that such termination shall become effective only after the trustees have accepted the termination of assignment and communicated their decision in writing to the asset management company.

(6) Notwithstanding anything contained in any contract or agreement or termination, the asset management company or its directors or other officers shall not be absolved of liability to the mutual fund for their acts of commission or omission, while holding such position or office.

(6A) The Chief Executive Officer (whatever his designation may be) of the asset management company shall ensure that the mutual fund complies with all the provisions of these regulations and the guidelines or circulars issued in relation thereto from time to time and that the investments made by the fund managers are in the interest of the unit holders and shall also be responsible for the overall risk management function of the mutual fund.

Explanation:— For the purpose of this sub-regulation, the words “these regulations” shall mean and include the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 as amended from time to time.

(6B) The fund managers (whatever the designation may be) shall ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders.

(7) (a) An asset management company shall not through any broker associated with the sponsor, purchase or sell securities, which is average of 5 per cent or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes:

Provided that for the purpose of this sub-regulation, the aggregate purchase and sale of securities shall exclude sale and distribution of units issued by the mutual fund :

Provided further that the aforesaid limit of 5 per cent shall apply for a block of any three months.

(b) An asset management company shall not purchase or sell securities through any broker [other than a broker referred to in clause (a) of sub-regulation (7) which is average of 5 per cent or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes, unless the asset management company has recorded in writing the justification for exceeding the limit of 5 per cent and reports of all such investments are sent to the trustees on a quarterly basis :

Provided that the aforesaid limit shall apply for a block of three months.

(8) An asset management company shall not utilize the services of the sponsor or any of its associates, employees or their relatives, for the purpose of any securities transaction and distribution and sale of securities:

Provided that an asset management company may utilize such services if disclosure to that effect is made to the unit holders and the brokerage or commission paid is also disclosed in the half-yearly annual accounts of the mutual fund :

Provided further that the mutual funds shall disclose at the time of declaring half-yearly and yearly results :

(i) any underwriting obligations undertaken by the schemes of the mutual funds with respect to issue of securities associate companies,

(ii) devolvement, if any,

(iii) subscription by the schemes in the issues lead managed by associate companies,

(iv) subscription to any issue of equity or debt on private placement basis where the sponsor or its associate companies have acted as arranger or manager.

(9) The asset management company shall file with the trustees the details of transactions in securities by the key personnel of the asset management company in their own name or on behalf of the asset management company and shall also report to the Board, as and when required by the Board.

(10) In case the asset management company enters into any securities transactions with any of its associates a report to that effect shall be sent to the trustees at its next meeting.

(11) In case any company has invested more than 5 per cent of the net asset value of a scheme, the investment made by that scheme or by any other scheme of the same mutual fund in that company or its subsidiaries shall be brought to the notice of the trustees by the asset management company and be disclosed in the half-yearly and annual accounts of the respective schemes with

justification for such investment

Provided the latter investment has been made within one year of the date of the former investment calculated on either side.

(12) The asset management company shall file with the trustees and the Board—

(a) detailed bio-data of all its directors along with their interest in other companies within fifteen days of their appointment;

(b) any change in the interests of directors every six months; and

(c) a quarterly report to the trustees giving details and adequate justification about the purchase and sale of the securities of the group companies of the sponsor or the asset management company, as the case may be, by the mutual fund during the said quarter.

(13) Each director of the asset management company shall file the details of his transactions of dealing in securities with the trustees on a quarterly basis in accordance with guidelines issued by the Board.

(14) The asset management company shall not appoint any person as key personnel who has been found guilty of any economic offence or involved in violation of securities laws.

(15) The asset management company shall appoint registrars and share transfer agents who are registered with the Board:

Provided if the work relating to the transfer of units is processed in-house, the charges at competitive market rates may be debited to the scheme and for rates higher than the competitive market rates, prior approval of the trustees shall be obtained and reasons for charging higher rates shall be disclosed in the annual accounts.

(16) The asset management company shall abide by the Code of Conduct as specified in the Fifth Schedule.

(17) The asset management company shall not invest in any of its scheme, unless full disclosure of its intention to invest has been made in the offer documents, in case of schemes launched after the notification of Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011:

Provided that an asset management company shall not be entitled to charge any fee on its investment in that scheme.

(18) The asset management company shall not carry out its operations including trading desk, unit holder servicing and investment operations outside the territory of India:

Provided that the asset management company having any of its operations outside India shall wind up and bring them within the territory of India within a period of one year form the date of notification of Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011:

Provided further that the Board may grant a further period of one year if it is satisfied that there was sufficient cause for not winding up of the operation outside India within that period.]

(19) The asset management company shall compute and carry out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule, and shall publish the same.

(20) The asset management company and the sponsor of the mutual fund shall be liable to compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation.

(21) The asset management company shall report and disclose all the transactions in debt and money market securities, including inter scheme transfers, as may be specified by the Board.

Appointment of custodian

26. (1) The mutual fund shall appoint a Custodian to carry out the custodial services for the schemes of the fund and sent intimation of the same to the Board within fifteen days of the appointment of the Custodian:

Provided that in case of a gold exchange traded fund scheme, the assets of the scheme being gold or gold related instruments may be kept in custody of a bank which is registered as a custodian with the Board.

Provided further that in case of a real estate mutual fund scheme, the title deed of real estate assets held by it may be kept in the custody of a custodian registered with the Board.

Provided also that mutual fund schemes investing in exchange traded commodity derivatives may appoint a custodian to have custody of the underlying goods in case of physical settlement of such contracts.

(2) No custodian in which the sponsor or its associates hold 50 per cent or more of the voting rights of the share capital of the custodian or where 50 per cent or more of the directors of the custodian represent the interest of the sponsor or its associates shall act as custodian for a mutual fund constituted by the same sponsor or any of its associates or subsidiary company:

Provided that where the sponsor or its associates hold 50 per cent or more of the voting rights of the share capital of the custodian, such custodian may act as custodian for a mutual fund constituted by the same sponsor or any of its associates or subsidiary company if:

(i) the sponsor has a net worth of at least twenty thousand crore rupees at all points of time;

(ii) 50 per cent or more of the directors of the custodian are those who do not represent the interest of the sponsor or its associates;

(iii) the custodian and the asset management company of a mutual fund are not subsidiaries of each other;

(iv) no person is a director of both the custodian and the asset management company of a mutual fund; and

(v) the custodian and the asset management company of a mutual fund sign an undertaking that they will act independently of each other in their dealings with the scheme

Agreement with custodian

27. The mutual fund shall enter into a custodian agreement with the custodian, which shall contain the clauses which are necessary for the efficient and orderly conduct of the affairs of the custodian:

Provided that the agreement, the service contract, terms and appointment of the custodian shall be entered into with the prior approval of the trustees.

CHAPTER V

SCHEMES OF MUTUAL FUND

Procedure for launching of schemes

28. (1) No scheme shall be launched by the asset management company unless such scheme is approved by the trustees and a copy of the offer document has been filed with the Board.

(2) The mutual fund shall pay the minimum filing fee specified in the Second Schedule to the Board while filing the offer document under sub-regulation (1).

(3) The mutual fund shall pay the balance filing fee calculated in accordance with the Second Schedule to the Board within such time as may be specified by the Board.

(4) The sponsor or asset management company shall invest not less than one percent of the amount which would be raised in the new fund offer or fifty lakh rupees, whichever is less, in the growth option of the scheme and such investment shall not be redeemed unless the scheme is wound up:

Provided that this sub-regulation shall not apply to close ended schemes.

(5) The sponsor or asset management company of schemes existing as on date of notification of the SEBI (Mutual Funds)(Amendment) Regulations, 2014 shall invest not less than one percent of the assets under management of the scheme as on date of notification of these regulations or fifty lakh rupees, whichever is less, in the growth option of the scheme and such investment shall not be redeemed unless the scheme is wound up:

Provided that the amount calculated as per this sub-regulation shall be invested within one year from the date of notification of these regulations:

Provided further this sub-regulation shall not apply to close ended schemes.

29. Disclosures in the offer document

(1) The offer document shall contain disclosures which are adequate in order to enable the investors to make informed investment decision 78[including the disclosure on maximum investments proposed to be made by the scheme in the listed securities of the group companies of the sponsor.

(2) The Board may in the interest of investors require the asset management company to carry out such modifications in the offer document as it deems fit.

(3) In case no modifications are suggested by the Board in the offer document within 21 working days from the date of filing, the asset management company may issue the offer document.

(4) No one shall issue any form of application for units of a mutual fund unless the form is accompanied by the memorandum containing such information as may be specified by the Board.

(5) The offer document shall contain the disclosure regarding the prior in principle approval obtained from the recognized stock exchange(s), where units are proposed to be listed in accordance with these regulations.

Nomination

29A. (1) The asset management company shall provide an option to the unit holder to nominate, in the manner specified in Fourth Schedule, a person in whom the units held by him shall vest in the event of his death.

(2) Where the units are held by more than one person jointly, the joint unit holders may together nominate a person in whom all the rights in the units shall vest in the event of death of all the joint unit holders.

Advertisement material

30. Advertisements shall be in conformity with the Advertisement Code as specified in the Sixth Schedule and shall be submitted to the Board within 7 days from the date of issue.

Misleading statements

31. The offer document and advertisement materials shall not be misleading or contain any statement or opinion which are incorrect or false.

In-principle approval from recognised stock exchange(s).

31A. The listed entity, which intends to list units of its scheme on the recognised stock exchange(s), shall obtain 'in-principle' approval from recognised stock exchange(s) in the manner as specified by the recognised stock exchange(s) from time to time.

Listing Agreement

31B. (1) Every mutual fund desirous of listing units of its schemes on a recognised stock exchange shall execute an agreement with such stock exchange.

(2) Every mutual fund which has previously entered into agreements with a recognised stock exchange to list units of its schemes shall execute a fresh listing agreement with such stock exchange within six months of the date of notification of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Listing of close ended schemes

32. Every close ended scheme, other than an equity linked savings scheme, shall be listed on a recognised stock exchange within such time period and subject to such conditions as specified by the Board:

Provided that listing of close ended scheme launched prior to the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be mandatory

(a) if the said scheme provides for periodic repurchase facility to all the unit holders with restriction, if any, on the extent of such repurchase; or

(b) if the said scheme provides for monthly income or caters to special classes of persons like senior citizens, women, children, widows or physically handicapped or any special class of persons providing for repurchase of units at regular intervals; or

(c) if the details of such repurchase facility are clearly disclosed in the offer document; or

(d) if the said scheme opens for repurchase within a period of six months from the closure of subscription; or

(e) if the said scheme is a capital protection oriented scheme.

Repurchase of close ended schemes

33. (1) Units of a close ended scheme, other than those of an equity linked savings scheme, launched on or after the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be repurchased before the end of maturity period of such scheme.

(2) The units of close ended schemes referred to in the proviso to regulation 32 may be open for sale or redemption at fixed predetermined intervals if the maximum and minimum amount of sale or redemption of the units and the periodicity of such sale or redemption have been disclosed in the offer document.

(3) The units of close ended scheme may be converted into open-ended scheme,—

(a) if the offer document of such scheme discloses the option and the period of such conversion; or

(b) the unit holders are provided with an option to redeem their units in full and

(c) the initial issue expenses of the scheme launched prior to commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2008 have been amortised fully in accordance with the Tenth Schedule.

(4) A close ended scheme shall be fully redeemed at the end of the maturity period

Provided that a close-ended scheme may be allowed to be rolled over if the purpose, period and other terms of the roll over and all other material details of the scheme including the likely composition of assets immediately before the roll over, the net assets and net asset value of the scheme, are disclosed to the unit holders and a copy of the same has been filed with the Board :

Provided further that such roll over will be permitted only in the case of those unit holders who express their consent in writing and the unit holders who do not opt for the roll over or have not given written consent shall be allowed to redeem their holdings in full at net asset value based price.

Offering period

34. No scheme of a mutual fund other than the initial offering period of any equity linked savings schemes shall be open for subscription for more than 15 days:

Provided that in case of mutual fund schemes eligible under Rajiv Gandhi Equity Savings Scheme, the period specified in this regulation shall not be more than thirty days.

Allotment of units and refunds of moneys

35. (1) The asset management company shall specify in the offer document,—

(a) the minimum subscription amount it seeks to raise under the scheme; and

(b) in case of oversubscription the extent of subscription it may retain :

Provided that where the asset management company retains the oversubscription referred to in clause (b), all the applicants applying upto five thousand units shall be given full allotment subject to the oversubscription mentioned in clause (b).

(2) The mutual fund and asset management company shall be liable to refund the application money to the applicants,—

(i) if the mutual fund fails to receive the minimum subscription amount referred to in clause (a) of sub-regulation (1);

(ii) if the moneys received from the applicants for units are in excess of subscription as referred to in clause (b) of sub-regulation (1).

(3) Any amount refundable under sub-regulation (2) shall be refunded within a period of five working days from the date of closure of subscription list, by Registered post with acknowledgement due and by cheque or demand draft marked “A/c payee” to the applicants:

Provided that in case of mutual fund schemes eligible under Rajiv Gandhi Equity Savings

Scheme, the period specified in this sub-regulation shall be fifteen days from the closure of the initial subscription list.

(4) In the event of failure to refund the amounts within the period specified in sub regulation (3), the asset management company shall be liable to pay interest to the applicants at a rate of fifteen per cent per annum from the expiry of five working days from the date of closure of the subscription list:

Provided that in case of mutual fund schemes eligible under Rajiv Gandhi Equity Savings Scheme, the period specified in this sub-regulation shall be fifteen days from the closure of the initial subscription list.

Statement of accounts or unit certificates

36. (1) The asset management company shall issue to the applicant whose application has been accepted, a statement of accounts specifying the number of units allotted to the applicant as soon as possible but not later than five working days from the date of closure of the initial subscription list and/or from the date of receipt of the request from the unit holders in any open ended scheme:

Provided that if an applicant so desires, the asset management company shall issue the unit certificates to the applicant within five working days of the receipt of request for the certificate:

Provided further that in case of mutual fund schemes eligible under Rajiv Gandhi Equity Savings Scheme, the period specified in this sub-regulation shall be fifteen days from the closure of the initial subscription list.

(2) An applicant in a close ended scheme whose application has been accepted shall have the option either to receive the statement of accounts or to hold units in dematerialised form and the asset management company shall issue to such applicant, a statement of accounts specifying the number of units allotted to the applicant or issue units in dematerialized form as soon as possible but not later than five working days from the date of closure of the initial subscription list:

Provided that in case of mutual fund schemes eligible under Rajiv Gandhi Equity Savings Scheme, the period specified in this sub-regulation shall be fifteen days from the closure of the initial subscription list.

(3) The asset management company shall issue units in dematerialized form to a unit holder in a close ended scheme listed on a recognised stock exchange within two working days of the receipt of request from the unit holder.

(4) The asset management company shall ensure that consolidated account statement for each calendar month is issued, on or before tenth day of succeeding month, detailing all the transactions and holding at the end of the month including transaction charges paid to the distributor, across all schemes of all mutual funds, to all the investors in whose folios transaction has taken place during that month:

Provided that the asset management company shall ensure that a consolidated account statement every half yearly (September/ March) is issued, on or before tenth day of succeeding month, detailing holding at the end of the six month, across all schemes of all mutual funds, to all such investors in whose folios no transaction has taken place during that period:

Provided further that the asset management company shall identify common investor across fund houses by their permanent account number for the purposes of sending consolidated account statement.

Explanation:- For the purpose of this regulation, the word 'transaction' shall include purchase, redemption, switch, dividend payout, dividend reinvestment, systematic investment plan, systematic withdrawal plan, systematic transfer plan and bonus transactions.

Transfer of units

37. (1) A unit unless otherwise restricted or prohibited under the scheme, shall be freely transferable by act of parties or by operation of law.

(1A) A unit holder, in a close ended scheme listed on a recognized stock exchange, who desires to trade in units shall hold units in dematerialised form.

(2) The asset management company shall, on production of instrument of transfer together with relevant unit certificates, register the transfer and return the unit certificate to the transferee within thirty days from the date of such production:

Provided that if the units are with the depository such units will be transferable in accordance with the provisions of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996.

Guaranteed returns

38. No guaranteed return shall be provided in a scheme

(a) unless such returns are fully guaranteed by the sponsor or the asset management company;

(b) unless a statement indicating the name of the person who will guarantee the return, is made in the offer document;

(c) the manner in which the guarantee is to be met has been stated in the offer document.

Capital Protection oriented schemes

38A. A capital protection oriented scheme may be launched, subject to the following:

(a) the units of the scheme are rated by a registered credit rating agency from the viewpoint of the ability of its portfolio structure to attain protection of the capital invested therein;

(b) the scheme is close ended; and

(c) there is compliance with such other requirements as may be specified by the Board in this behalf.

Winding up

39. (1) A close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled over for a further period under sub-regulation (4) of regulation 33.

(2) A scheme of a mutual fund may be wound up, after repaying the amount due to the unit holders,

(a) on the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up; or

(b) if seventy-five per cent of the unit holders of a scheme pass a resolution that the scheme be wound up; or

(c) if the Board so directs in the interest of the unit holders.

(3) Where a scheme is to be wound up under sub-regulation (2), the trustees shall give notice disclosing the circumstances leading to the winding up of the scheme:—

(a) to the Board; and

(b) in two daily newspapers having circulation all over India, a vernacular newspaper circulating at the place where the mutual fund is formed.

Effect of winding up

40. On and from the date of the publication of notice under clause (b) of sub-regulation (3) of regulation 39, the trustee or the asset management company as the case may be, shall—

(a) cease to carry on any business activities in respect of the scheme so wound up;

(b) cease to create or cancel units in the scheme;

(c) cease to issue or redeem units in the scheme.

Procedure and manner of winding up

41. (1) The trustee shall call a meeting of the unit holders to approve by simple majority of the unit holders present and voting at the meeting resolution for authorising the trustees or any other person to take steps for winding up of the scheme:

Provided that a meeting of the unit holders shall not be necessary if the scheme is wound up at the end of maturity period of the scheme.

(2) (a) The trustee or the person authorised under sub-regulation (1) shall dispose of the assets of the scheme concerned in the best interest of the unit holders of that scheme.

(b) The proceeds of sale realised under clause (a), shall be first utilised towards discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unit holders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken.

(3) On the completion of the winding up, the trustee shall forward to the Board and the unit holders a report on the winding up containing particulars such as circumstances leading to the winding up, the steps taken for disposal of assets of the fund before winding up, expenses of the fund for winding up, net assets available for distribution to the unit holders and a certificate from the auditors of the fund.

(4) Notwithstanding anything contained in this regulation, the provisions of these regulations in respect of disclosures of half-yearly reports and annual reports shall continue to be applicable until winding up is completed or the scheme ceases to exist].

Winding up of the scheme

42. After the receipt of the report under sub-regulation (3) of regulation 41, if the Board is satisfied that all measures for winding up of the scheme have been complied with, the scheme shall cease to exist.

Delisting of units

42A. The units of a mutual fund scheme shall be delisted from a recognised stock exchange in accordance with the guidelines as may be specified by the Board.

CHAPTER VI

INVESTMENT OBJECTIVES AND VALUATION POLICIES

Investment objective

43. (1) Subject to other provisions of these regulations, a mutual fund may invest moneys collected under any of its schemes only in—

(a) securities;

(b) money market instruments;

(c) privately placed debentures;

(d) securitised debt instruments, which are either asset backed or mortgage backed securities;

(e) gold or gold related instruments; or

(f) real estate assets as defined in clause (a) of regulation 49A; or

(g) infrastructure debt instrument and assets as specified in clause (1) of regulation 49L

(2) Any investment made under sub-regulation (1) shall be in accordance with the investment objective of the relevant mutual fund scheme.

(3) Moneys collected under any money market scheme of a mutual fund shall be invested only in money market instruments.

(4) Moneys collected under any gold exchange traded fund scheme shall be invested only in gold or gold related instruments, in accordance with sub-regulation (5) of regulation 44.

(5) Moneys collected under a real estate mutual fund scheme shall be invested in accordance with regulation 49E.

Investment, borrowing, restriction, etc

44. (1) Any investment to be made under regulation 43 shall be invested subject to the investment restriction specified in the Seventh Schedule:

Provided that nothing in the Seventh Schedule, save clause 14 therein shall apply to a gold exchange traded fund scheme.

(1A) The mutual fund having an aggregate of securities which are worth ₹ 10 crores or more, as on the latest balance-sheet date, shall subject to such instructions as may be issued from time to time by the Board settle their transactions entered on or after January 15, 1998, only through dematerialised securities.

(2) The mutual fund shall not borrow except to meet temporary liquidity needs of the mutual funds for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders:

Provided that the mutual fund shall not borrow more than 20 per cent of the net asset of the scheme and the duration of such a borrowing shall not exceed a period of six months.

(3) Save as otherwise expressly provided under these regulations, the mutual fund shall not advance any loans for any purpose.

(4) A mutual fund may lend and borrow securities in accordance with the framework relating to short selling and securities lending and borrowing specified by the Board.

(5) A gold exchange traded fund scheme shall be subject to the following investment restrictions:

(a) the funds of any such scheme shall be invested only in gold or gold related instruments in accordance with its investment objective, except to the extent necessary to meet the liquidity requirements for honoring repurchases or redemptions, as disclosed in the offer document; and

(b) pending deployment of funds in accordance with clause (b), the mutual fund may invest such funds in short-term deposits of scheduled commercial banks.

Carry forward transactions, derivatives transactions and short selling transactions

45. (1) The funds of a scheme shall not in any manner be used in carry forward transactions:

Provided that a mutual fund may enter into derivatives transactions on a recognized stock exchange, subject to the framework specified by the Board.

(2) A mutual fund may enter into short selling transactions on a recognized stock exchange, subject to the framework relating to short selling and securities lending and borrowing specified by the Board.

Underwriting of securities

46. Mutual funds may enter into underwriting agreement after obtaining a certificate of registration in terms of the Securities and Exchange Board of India (Underwriters) Rules and Securities and Exchange Board of India (Underwriters) Regulations, 1993 authorising it to carry on activities as underwriters.

Explanation: (1) For the purpose of these regulations, the underwriting obligation will be deemed as if investments are made in such securities.

(2) The capital adequacy norms for the purpose of underwriting shall be the net asset of the scheme:

Provided that the underwriting obligation of a mutual fund shall not at any time exceed the total net asset value of the scheme.

Valuation of investments

47. Every mutual fund shall ensure that the asset management company computes and carries out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule, and publishes the same.

Computation of Net Asset Value

48. (1) Every mutual fund shall compute the Net Asset Value of each scheme by dividing the net assets of the scheme by the number of units outstanding on the valuation date.

(2) The Net Asset Value of the scheme shall be calculated on daily basis and disclosed in the manner specified by the Board.

Pricing of Units

49. (1) The price at which the units may be subscribed or sold and the price at which such units may at any time be repurchased by the mutual fund shall be made available to the investors in the manner specified by the Board.

(2) The mutual fund shall provide the methodology of calculating the sale and repurchase price of units in the manner specified by the Board.

(3) While determining the prices of the units, the mutual fund shall ensure that the repurchase price is not lower than 93 per cent of the Net Asset Value and the sale price is not higher than 107 per cent of the Net Asset Value:

Provided that the repurchase price of the units of close ended scheme launched prior to the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be lower than ninety five per cent of the Net Asset Value:

Provided further that the difference between the repurchase price and the sale price of the unit shall not exceed 7 per cent calculated on the sale price:

(3A) Where a mutual fund repurchases units in a close ended scheme launched prior to the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 which fulfills the conditions mentioned in sub-regulation

(3B), it shall deduct an amount representing proportionate initial issue expenses or part thereof remaining unamortized, from the repurchase proceeds.

Explanation: The term "proportionate initial issue expenses or part thereof remaining unamortised" refers to such proportion of the expenses of the scheme as are attributable to the units being repurchased. (3B) The conditions referred to in sub-regulation (3A) are the following:

(a) the scheme is launched after the commencement of the Securities and Exchange Board of India (Mutual Funds) (Second Amendment) Regulations, 2006 and prior to commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2008;

(b) initial issue expenses in respect of the scheme are accounted in the books of accounts of the scheme in accordance with Tenth Schedule.

(3C) The amount recovered under sub-regulation (3A) shall be credited to the unamortized initial issue expenses of the scheme.

(4) The price of units shall be determined with reference to the last determined Net Asset Value as mentioned in sub-regulation (3) unless,

(a) the scheme announces the Net Asset Value on a daily basis; and

(b) the sale price is determined with or without a fixed premium added to the future net asset value which is declared in advance.

CHAPTER VIA

REAL ESTATE MUTUAL FUND SCHEMES

Definitions

49A. For the purposes of this Chapter, unless the context otherwise requires-

(a) "real estate asset" means an identifiable immovable property-

(i) which is located within India in such city as may be specified by the Board from time to time or in a special economic zone within the meaning of clause (za) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005);

(ii) on which construction is complete and which is usable;

(iii) which is evidenced by valid title documents;

(iv) which is legally transferable;

(v) which is free from all encumbrances;

(vi) which is not subject matter of any litigation; but does not include-

I. a project under construction; or 4

II. vacant land; or

III. deserted property; or

IV. land specified for agricultural use; or

V. a property which is reserved or attached by any Government or other authority or pursuant to orders of a court of law or the acquisition of which is otherwise prohibited under any law for the time being in force;

(b) "real estate valuer" means a qualified valuer of real estate assets who has been accredited by a credit rating agency registered with the Board.

Applicability

49B. (1) The provisions of this Chapter shall apply to real estate mutual fund schemes.

(2) Unless the context otherwise requires, all other provisions of these regulations and the guidelines and circulars issues thereunder shall apply to real estate mutual fund schemes, and trustees and asset management companies in relation to such schemes, except where specific provisions are made in relation thereto under this Chapter.

Additional eligibility criteria

49C. (1) A Certificate of registration may be granted under regulation 9 to an applicant proposing to launch only real estate mutual fund schemes if he;-

(a) has been carrying on business in real estate for a period of not less than five years;

(b) fulfills eligibility criteria provided in regulation 7, except that specified in item (i) of the Explanation to clause (a) thereof:

(2) A real estate mutual fund scheme of a mutual fund registered under sub regulation (1) shall not invest in the securities mentioned in sub-clauses (ii) to (iii) of clause (a) or in clause (b) of sub-

regulation (2) of regulation 49E unless it has key personnel having adequate professional experience in finance and financial services related field.

(3) An existing mutual fund may launch a real estate mutual fund scheme if it has an adequate number of key personnel and directors having adequate experience in real estate.

Other conditions for real estate mutual fund schemes

49D. (1) Every real estate mutual fund scheme shall be close-ended and its units shall be listed on a recognized stock exchange:

Provided that the redemption of a real estate mutual fund scheme may be done in a staggered manner.

(2) The units issued by a real estate mutual fund scheme shall not confer any right on the unit holders to use the real estate assets held by the scheme and any provision to the contrary in the trust deed or in the terms of issue shall be void.

(3) The title deeds pertaining to real estate assets held by a real estate mutual fund scheme shall be kept in safe custody with the custodian of the mutual fund.

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

(5) All financial transactions of a real estate mutual fund scheme shall be routed through banking channels and they shall not be cash or unaccounted transactions.

Permissible investments

49E. (1) Every real state mutual fund scheme shall invest at least thirty five per cent. of the net assets of the scheme directly in real estate assets.

(2) Subject to sub-regulation (1), every real estate mutual fund scheme shall invest-

(a) at least seventy five per cent. of the net assets of the scheme in-

(i) real estate assets;

(ii) mortgage backed securities (but not directly in mortgages);

(iii) equity shares or debentures of companies engaged in dealing in real estate assets or in undertaking real estate development projects, whether listed on a recognized stock exchange in India or not; (b) the balance in other securities;

(3) Unless otherwise disclosed in the offer document, no mutual fund shall, under all its real estate mutual fund schemes, invest more than thirty per cent. of its net assets in a single city.

(4) No mutual fund shall, under all its real estate mutual fund schemes, invest more than fifteen per cent. of its net assets in the real estate assets of any single real estate project.

Explanation: For the purposes of this regulation, “single real estate project” means a project by a builder in a single location within a city.

(5) No mutual fund shall, under all its real estate mutual fund schemes, invest more than twenty five per cent. of the total issued capital of any unlisted company.

(6) No mutual fund shall invest more than fifteen per cent of the net assets of any of its real estate mutual fund schemes in the equity shares or debentures of any unlisted company.

(7) No real estate mutual fund scheme shall invest in –

(a) any unlisted security of the sponsor or its associate or group company;

(b) any listed security issued by way of preferential allotment by the sponsor or its associate orgroup company;

(c) any listed security of the sponsor or its associate or group company, in excess of twenty five per cent of the net assets of the scheme.

(8) No mutual fund shall transfer real estate assets amongst its schemes.

(9) No mutual fund shall invest in any real estate asset which was owned by the sponsor or the asset management company or any of its associates during the period of last five years or in which the sponsor or the asset management company or any of its associates hold tenancy or lease rights.

Valuation of real estates assets and declaration of net asset value

49F. (1) The real estate assets held by a real estate mutual fund scheme shall be valued –

(a) at cost price on the date of acquisition; and

(b) at fair price on every ninetieth day from the day of its purchase in accordance with the norms specified in Schedule IXB.

(2) The asset management company, its directors, the trustees and the real estate valuer shall ensure that the valuation of assets held by a real estate mutual fund scheme are done in good faith, in accordance with the norms specified in Schedule IX B and that the accounts of the scheme are prepared in accordance with accounting principles specified in Schedule XI.

(3) The net asset value of every real estate mutual fund scheme shall be calculated and declared at the close of each business day on the basis of the most current valuation of the real estate assets held by the scheme and accrued income thereon, if any.

Duties of asset management company

49G. (1) Without prejudice to the provisions of regulation 21, the asset management company of a mutual fund having real estate mutual fund schemes shall appoint suitable number of qualified key personnel with relevant experience, before undertaking investment management of real estate assets of a real estate mutual fund scheme.

(2) The asset management company may appoint advisors to advise it on acquisitions or proposed acquisitions of real estate assets.

(3) The asset management company shall exercise due care while appointing real estate valuers for valuing the real estate assets held by the real estate mutual fund scheme and shall ensure that there is no conflict of interest.

(4) The asset management company shall lay down an adequate system of internal controls and risk management.

(5) The asset management company shall put in place systems to ensure that all financial transactions are done through banking channels and exclude transactions in cash or unaccounted transactions.

(6) The asset management company shall exercise due diligence in maintenance of the assets of a real estate mutual fund scheme and shall ensure that there is no avoidable deterioration in their value.

(7) The asset management company shall ensure that the real estate assets held by a real estate mutual fund scheme are adequately insured against impair, damage or destruction.

(8) The asset management company shall ensure that the cost of maintenance and insurance of real estate assets is within reasonable limits and that no funds of the scheme are utilized towards development of such assets.

(9) The asset management company shall ensure that a real estate valuer certifies compliance with sub-regulation (8) on an annual basis.

(10) The asset management company shall ensure that no real estate valuer continues with valuation of particular real estate asset for more than two years and that no such valuer values the same asset for a period of at least three years thereafter.

(11) The asset management company shall record in writing, the details of its decision making process in buying or selling real estate assets together with the justifications for such decisions and forward the same periodically to trustees.

(12) The asset management company shall ensure that investment of funds of the real estate mutual fund scheme is not made contrary to provisions of this chapter and the trust deed.

(13) The asset management company shall obtain, wherever required under these regulations, prior in-principle approval from the recognized stock exchange(s) where units are proposed to be listed.

Usage of real estate assets of a real estate mutual fund scheme

49H. (1) The asset management company may let out or lease out the real estate assets held by the real estate mutual fund scheme if the term of such lease or letting does not extend beyond the period of maturity of the scheme.

(2) Where real estate assets are let out or leased out, the asset management company shall diligently collect the rents or other income in a timely manner.

(3) Real estate assets held by a real estate mutual fund scheme may be let out to the sponsor, asset management company or any of their associates, at market price or otherwise on commercial terms:

Provided that not more than 25% of the total rental income of the scheme shall be derived from assets so let out.

Duties of trustees

49I. (1) The trustees shall ensure that the asset management company has the necessary expertise, internal control systems and risk management mechanism to invest in and manage investments in real estate assets on a continuous basis.

(2) The trustees shall monitor whether due diligence is exercised by the asset management company in managing the investments.

(3) The trustees shall review the market price of the units during the year and shall recommend proportionate buy back of units from unit holders, if the units are traded at steep discount to the net asset value.

(4) The magnitude of discount which shall amount to steep discount referred to in sub regulation (3) shall be disclosed in the offer document.

(5) The trustees shall ensure that only permissible investments are made by the asset management company.

(6) The trustees shall ensure that all financial transactions of the real estate mutual fund scheme are made only through banking channels and that systems exist to exclude transactions in cash and unaccounted transactions.

(7) The trustees shall lay down the criteria for empanelment of real estate brokers.

(8) The trustees shall lay down the broad procedure to be followed by the assert management company while transacting in real estate assets.

(9) The trustees shall require the asset management company to set up such systems and submit such reports to trustees, as may be necessary for them to effectively monitor the performance and functioning of the real estate mutual fund schemes.

(10) The trustees shall include a confirmation on compliance with sub regulation (9) in their half yearly reports made to the Board.

(11) The trustees shall obtain, wherever required under these regulations, prior in principle approval from the recognised stock exchange(s) where units are proposed to be listed.

Disclosures in offer document and other disclosures

49J. (1) The offer documents of real estate mutual fund schemes shall contain disclosures which are adequate for investors to make informed investment decisions and such further disclosures as may be specified by the Board.

(2) The portfolio disclosures and financial results in respect of a real estate mutual fund scheme shall contain such further disclosures as are specified by the Board.

(3) Advertisements in respect of real estate mutual fund schemes shall conform to such guidelines as may be specified by the Board.

Transactions by employees etc.

49K. (1) All transactions done by the trustees or the employees or directors of the asset management company or the trustee company in real estate assets shall be disclosed by them to the compliance officer within one month of the transaction.

(2) The compliance officer shall make a report thereon from the view point of possible conflict of interest and shall submit it to the trustees with his recommendations, if any.

(3) The persons covered in sub-regulation (1) may obtain the views of the trustees before entering into the transaction in real estate assets, by making a suitable request to them.

CHAPTER VI -B

INFRASTRUCTURE DEBT FUND SCHEMES

Definitions

49L. For the purposes of this Chapter, unless the context otherwise requires-

(1) "Infrastructure debt fund scheme" means a mutual fund scheme that invests primarily (minimum 90% of scheme assets) in the debt securities or securitized debt instrument of infrastructure companies or infrastructure capital companies or infrastructure projects or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure, and other permissible assets in accordance with these regulations or bank loans in respect of completed and revenue generating projects of infrastructure companies or projects or special purpose vehicles.

(2) "Infrastructure" includes the sectors as specified by guidelines issued by the Board or as notified by Ministry of Finance, from time to time.

(3) 'Strategic Investor' means;

(i) an Infrastructure Finance Company registered with Reserve bank of India as Non Banking Financial Company;

(ii) a Scheduled Commercial Bank;

(iii) International Multilateral Financial Institution;

(iv) Systemically Important Non Banking Financial Companies registered with Reserve Bank of India;

(v) Foreign Institutional Investors registered with the Board, subject to their applicable investment limits, which are long term investors in terms of the norms specified by SEBI.

Applicability

49M. (1) The provisions of this chapter shall apply to infrastructure debt fund schemes launched by mutual funds.

(2) All other provisions of these regulations and the guidelines and circulars issued thereunder, unless the context otherwise require or repugnant to the provisions of this chapter, shall apply to infrastructure debt fund schemes, trustees and asset management companies in relation to such schemes.

Eligibility criteria for launching infrastructure debt fund scheme

49N. (1) An existing mutual fund may launch an infrastructure debt fund schemes if it has an adequate number of key personnel having adequate experience in infrastructure sector.

(2) A certificate of registration may be granted under regulation 9 to an applicant proposing to launch only infrastructure debt fund schemes if the sponsor or the parent company of the sponsor: -

(a) has been carrying on activities or business in infrastructure financing sector for a period of not less than five years;

(b) fulfills eligibility criteria provided in Regulation 7.

Explanation- For the purpose of this clause, 'parent company of the sponsor' shall mean a company which holds at least 75% of paid up equity share capital of the sponsor.

Offering period

49NA. No scheme of an infrastructure debt fund, in the case of a public offer, shall be open for subscription for more than forty five days.

Conditions for infrastructure debt fund schemes

49O. (1) An infrastructure debt fund scheme shall be launched either as close-ended scheme maturing after more than five years or interval scheme with lock-in of five years and specified transaction period of not more than forty five days as may be specified in the scheme information document.

Provided that the tenure of the scheme may be extended to two years subject to approval of two-thirds of the unit holders by value of their investment in the scheme.

(2) Units of infrastructure debt fund schemes shall be listed on a recognized stock exchange, provided that such units shall be listed only after being fully paid up.

(3) Mutual Funds may disclose indicative portfolio of infrastructure debt fund scheme to its potential investors disclosing the type of assets the mutual fund will be investing.

(4) An infrastructure debt fund scheme shall have minimum five investors and no single investor shall hold more than fifty percent of net assets of the scheme.

(5) No infrastructure debt fund scheme shall accept any investment from any investor which is less than Rupees one crore.

(6) The minimum size of the unit shall be Rupees ten lakhs.

(7) Each scheme launched as infrastructure debt fund scheme shall have firm commitment from the strategic investors for contribution of an amount of at least Rupees twenty five crores before the allotment of units of the scheme are marketed to other potential investors.

(8) Mutual Funds launching infrastructure debt fund scheme may issue partly paid units to the investors, subject to following conditions:

(a) The asset management company shall call for the unpaid portions depending upon the deployment opportunities;

(b) The offer document of the scheme shall disclose the interest or penalty which may be deducted in case of nonpayment of call money by the investors within stipulated time; and

(c) The amount of interest or penalty shall be retained in the scheme.

Private Placement

49-OA. (1) The units of an infrastructure debt fund scheme may be offered through private placement to less than fifty persons, subject to approval by the trustees and the board of the asset management company.

(2) The offer made under sub-regulation (1), shall be subject to the following:

(a) A placement memorandum, in the manner as specified by the Board, shall be filed by the mutual fund with the Board at least seven days prior to the launch of the scheme; and

(b) the mutual fund shall pay to the Board, filing fee as specified in the Second Schedule.

Permissible investments

49P. (1) Every infrastructure debt fund scheme shall invest at least ninety percent of the net assets of the scheme in the debt securities or securitized debt instruments of infrastructure companies or projects or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure or bank loans in respect of completed and revenue generating projects of infrastructure companies or special purpose vehicle.

Provided that the funds received on account of re-payment of principal, whether by way of pre-payment or otherwise, with respect to the underlying assets of the scheme, shall be invested as specified in this sub-regulation:

Provided further that if the investments specified in this sub-regulation are not available, such funds may be invested in bonds of Public Financial Institutions and Infrastructure Finance Companies.

(2) Subject to sub-regulation (1), every infrastructure debt fund scheme may invest the balance amount in equity shares, convertibles including mezzanine financing instruments of companies engaged in infrastructure, infrastructure development projects, whether listed on a recognized stock exchange in India or not; or money market instruments and bank deposits.

(3) The investment restrictions shall be applicable on the life-cycle of the infrastructure debt fund scheme and shall be reckoned with reference to the total amount raised by the infrastructure debt fund scheme.

(4) No mutual fund shall, under all its infrastructure debt fund schemes, invest more than thirty per cent of its net assets in the debt securities or assets of any single infrastructure company or project or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure or bank loans in respect of completed and revenue generating projects of any single infrastructure company or project or special purpose vehicle.

(5) An infrastructure debt scheme shall not invest more than 30% of the net assets of the scheme in debt instruments or assets of any single infrastructure company or project or special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure or bank loans in respect of completed and revenue generating projects of any single infrastructure company or project or special purpose vehicle.

(5A) The overall investments by an infrastructure debt fund scheme in debt instruments or assets of infrastructure companies or projects or special purpose vehicles, which are created for the purpose of facilitating or promoting investment in infrastructure or bank loans in respect of completed and revenue generating projects of infrastructure companies or projects or special purpose vehicles, which are rated below investment grade or are unrated, shall not exceed 30% of the net assets of the scheme:

Provided that the overall investment limit may increase up to 50% of the net assets of the scheme with the prior approval of the trustees and the board of the asset management company.

(6) No infrastructure debt fund scheme shall invest in –

(i) Any unlisted security of the sponsor or its associate or group company;

(ii) Any listed security issued by way of preferential allotment by the sponsor or its associate or group company;

(iii) Any listed security of the sponsor or its associate or group company or bank loan in respect of completed and revenue generating projects of infrastructure companies or special purpose vehicles of the sponsor or its associate or group companies, in excess of twenty five per cent of the net assets of the scheme, subject to approval of trustees and full disclosures to investors for investments made within the aforesaid limits; or

(iv) any asset or securities owned by the sponsor or asset management company or their associates in excess of 30% of the net assets of the scheme, provided that-

(a) such investment is in assets or securities not below investment grade;

(b) the sponsor or its associates retains at least 30% of the assets or securities, in which investment is made by the scheme, till the assets or securities are held in the scheme portfolio; and

(c) approval for such investment is granted by the trustees and full disclosures are made to the investors regarding such investment.

Valuation of assets and declaration of net asset value

49Q. (1) The assets held by an infrastructure debt fund scheme shall be valued "in good faith" by the asset management company on the basis of appropriate valuation methods based on principles approved by the trustees.

(2) The valuation shall be documented and the supporting data in respect of each security so valued shall be preserved at least for a period of five years after the expiry of the scheme.

(3) The methods used to arrive at values 'in good faith' shall be periodically reviewed by the Trustees and by the statutory auditor of the mutual fund.

(4) The valuation policy approved by the board of asset management company shall be disclosed in the scheme information document.

(5) The net asset value of every infrastructure debt fund scheme shall be calculated and declared at least once in each quarter.

Duties of asset management company

49R. (1) The asset management company shall lay down an adequate system of internal controls and risk management.

(2) The asset management company shall exercise due diligence in maintenance of the assets of an infrastructure debt fund scheme and shall ensure that there is no avoidable deterioration in their value.

(3) The asset management company shall record in writing, the details of its decision making process in buying or selling infrastructure companies' assets together with the justifications for such decisions and forward the same periodically to trustees.

(4) The asset management company shall ensure that investment of funds of the Infrastructure Debt Fund schemes is not made contrary to provisions of this chapter and the trust deed.

(5) The asset management company shall obtain, wherever required under these regulations, prior

in-principle approval from the recognized stock exchange(s) where units are proposed to be listed.

(6) The asset management company shall institute such mechanisms as to ensure that proper care is taken for collection, monitoring and supervision of the debt assets by appointing a service provider having extensive experience thereof, if required.

Disclosures in offer document and other disclosures

49S. (1) The offer documents of infrastructure debt fund schemes shall contain disclosures which are adequate for investors to make informed investment decisions and such further disclosures as may be specified by the Board.

(2) The portfolio disclosures and financial results in respect of an infrastructure debt fund schemes shall contain such further disclosures as may be specified by the Board.

(3) Advertisements in respect of infrastructure debt fund schemes shall conform to such guidelines as may be specified by the Board.

Transactions by employees etc.

49T. (1) All transactions done by the trustees or the employees or directors of the asset management company or the trustee company in the investee companies shall be disclosed by them to the compliance officer within one month of the transaction.

(2) The compliance officer shall make a report thereon from the view point of possible conflict of interest and shall submit it to the trustees with his recommendations, if any.

(3) The persons covered in sub-regulation (1) may obtain the views of the trustees before entering into the transaction in investee companies, by making a suitable request to them.

CHAPTER VII

GENERAL OBLIGATIONS

50. To maintain proper books of account and records, etc.

(1) Every asset management company for each scheme shall keep and maintain proper books of account, records and documents, for each scheme so as to explain its transactions and to disclose at any point of time the financial position of each scheme and in particular give a true and fair view of the state of affairs of the fund and intimate to the Board the place where such books of account, records and documents are maintained.

(2) Every asset management company shall maintain and preserve for a period of eight years its books of account, records and documents.

(3) The asset management company shall follow the accounting policies and standards as specified in Ninth Schedule so as to provide appropriate details of the scheme wise disposition of

the assets of the fund at the relevant accounting date and the performance during that period together with information regarding distribution or accumulation of income accruing to the unit holder in a fair and true manner.

Financial year

51. The financial year for all the schemes shall end as of March 31st of each year;

Provided that, for a new scheme commenced during a financial year, the disclosure and reporting requirements would apply for the period beginning from the date of its commencement and ending on March 31st of that financial year.

Credit of exit load to scheme

51A. The exit load charged, if any, after the commencement of the SEBI (Mutual Funds) (Second Amendment) Regulations, 2012, shall be credited to the scheme.

52. Limitation on fees and expenses on issue of schemes

(1) All expenses should be clearly identified and appropriated in the individual schemes.

(2) The asset management company may charge the scheme with investment and advisory fees which shall be fully disclosed in the offer document.

(3) Deleted

(4) In addition to the fees mentioned in sub-regulation (2), the asset management company may charge the scheme with the following expenses, namely:—

(a) Deleted

(b) recurring expenses including:—

(i) marketing and selling expenses including agents' commission, if any ;

(ii) brokerage and transaction cost ;

(iii) registrar services for transfer of units sold or redeemed ;

(iv) fees and expenses of trustees ;

(v) audit fees ;

(vi) custodian fees ;

(vii) costs related to investor communication ;

(viii) costs of fund transfer from location to location ;

(ix) costs of providing account statements and dividend/redemption cheques and warrants ;

(x) insurance premium paid by the fund ;

(xi) winding up costs for terminating a fund or a scheme ;

(xii) costs of statutory advertisements ;

(xiia) in case of a gold exchange traded fund scheme, recurring expenses incurred towards storage and handling of gold;

(xiib) in case of a capital oriented scheme, rating fees;

(xiic) in case of a real estate mutual fund scheme, insurance premia and costs of maintenance of the real estate assets (excluding costs of development of such assets) over and above the expenses specified in regulation 52 to the extent disclosed in the offer document;

(xiid) listing fees, in case of schemes listed on a recognised stock exchange; and

(xiie) in case of schemes investing in exchange traded commodity derivatives, recurring expenses incurred towards storage and handling of the underlying goods, due to physical settlement of such contracts.

(xiii) such other costs as may be approved by the Board.

(5) Any expense other than those specified in sub-regulations (2) and (4) shall be borne by the asset management company or trustee or sponsors

(5A) In case of a scheme other than an index fund scheme or an exchange traded fund, where, as per the scheme information document, the scheme will invest a minimum of sixty-five per cent of its net assets in equity and equity related instruments, the scheme will be considered as equity oriented scheme for the purpose of limits of total expense ratio as specified in these regulations.

(6) The total expense ratio of the scheme excluding issue or redemption expenses, whether initially borne by the mutual fund or by the asset management company, but including the investment management and advisory fee shall be subject to the following limits:—

(a) in case of fund of funds scheme -

(i) investing in liquid schemes, index fund scheme and exchange traded funds, the total expense ratio of the scheme including weighted average of the total expense ratio levied by the underlying scheme(s) shall not exceed 1.00 per cent of the daily net assets of the scheme.

(ii) investing a minimum of sixty-five per cent of assets under management in equity oriented schemes as per scheme information document, the total expense ratio of the scheme including weighted average of the total expense ratio levied by the underlying scheme(s) shall not exceed 2.25 per cent of the daily net assets of the scheme.

(iii) investing in schemes other than as specified in clause (a)(i) and (a)(ii) of this sub regulation, the total expense ratio of the scheme including weighted average of the total expense ratio levied by the underlying scheme(s) shall not exceed 2.00 per cent of the daily net assets of the scheme:

Provided that the total expense ratio to be charged over and above the weighted average of the total expense ratio of the underlying scheme shall not exceed two times the weighted average of the total expense ratio levied by the underlying scheme(s), subject to the overall ceilings as stated at clause a(i), a(ii) and a(iii).

(b) in case of an index fund scheme or exchange traded fund, the total expense ratio of the scheme including the investment and advisory fees shall not exceed 1.00 per cent of the daily net assets.

(c) in case of open ended schemes other than as specified in clause (a) and (b) above, the total expense ratio of the scheme shall not exceed the following limits:

Assets under management Slab (In ₹ crore)	Total expense ratio limits for equity oriented schemes	Total expense ratio limits for other than equity oriented schemes
on the first ₹ 500 crores of the daily net assets	2.25%	2%
on the next ₹ 250 crores of the daily net assets	2%	1.75%
on the next ₹ 1,250 crores of the daily net assets	1.75%	1.50%
on the next ₹ 3,000 crores of the daily net assets	1.60%	1.35%
on the next ₹ 5,000 crores of the daily net assets	1.50%	1.25%
On the next ₹ 40,000 crores of the daily net assets	Total expense ratio reduction of 0.05% for every increase of ₹ 5,000 crores of daily net assets or part thereof.	
On balance of the assets	1.05%	0.80%

(d) in case of close ended and interval schemes,

(i) the total expense ratio of equity oriented scheme(s) shall not exceed 1.25 per cent of the daily net assets of the scheme.

(ii) the total expense ratio of close ended and interval scheme(s) other than schemes specified in clause d (i) above shall not exceed 1.00 per cent of the daily net assets of the scheme.

(6A) In addition to the limits specified in sub-regulation (6), the following costs or expenses may be charged to the scheme, namely-

(a) brokerage and transaction costs which are incurred for the purpose of execution of trade and is included in the cost of investment, not exceeding 0.12 per cent in case of cash market transactions and 0.05 per cent in case of derivatives transactions;

(b) expenses not exceeding of 0.30 per cent of daily net assets, if the new inflows from such cities as specified by the Board from time to time are at least -

(i) 30 per cent of gross new inflows in the scheme, or;

(ii) 15 per cent of the average assets under management (year to date) of the scheme, whichever is higher:

Provided that if inflows from such cities is less than the higher of sub-clause (i) or sub-clause (ii), such expenses on daily net assets of the scheme shall be charged on proportionate basis:

Provided further that expenses charged under this clause shall be utilised for distribution expenses incurred for bringing inflows from such cities:

Provided further that amount incurred as expense on account of inflows from such cities shall be credited back to the scheme in case the said inflows are redeemed within a period of one year from the date of investment;

(c) additional expenses, incurred towards different heads mentioned under sub-regulations (2) and (4), not exceeding 0.05 per cent of daily net assets of the scheme or as specified by the Board:

Provided that such additional expenses shall not be charged to the schemes where the exit load is not levied or applicable.

(7) Any expenditure in excess of the limits specified in sub-regulations (6) and (6A) shall be borne by the asset management company or by the trustee or sponsors.

(8) The provisions of sub-regulations (3), (4), (5) and (6) will come into effect from 1st April, 1997 for those schemes of mutual funds which have been launched prior to notification of these regulations.

Declaration of dividends

52A. A mutual fund may declare dividends in accordance with the offer document and subject to such Guidelines as may be specified by the Board.

Despatch of warrants and proceeds

53. Every mutual fund and asset management company shall,

(a) despatch to the unit holders the dividend warrants within 30 days of the declaration of the dividend;

(b) despatch the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase;

(c) in the event of failure to despatch the redemption or repurchase proceeds within the period specified in sub-clause (b), the asset management company shall be liable to pay interest to the unit holders at such rate as may be specified by the Board for the period of such delay;

(d) not withstanding payment of such interest to the unit-holders under sub clause (c), the asset management company may be liable for penalty for failure to despatch the redemption or repurchase proceeds within the stipulated time.

Annual Report

54. Every mutual fund or the asset management company shall prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund as specified in Eleventh Schedule.

Auditor's report

55. (1) Every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company.

Explanation: For the purposes of this sub-regulation and regulation 66 "auditor" means a person who is qualified to audit the accounts of a company under section 224 of the Companies Act, 1956 (1 of 1956).

(2) An auditor shall be appointed by the trustees.

(3) The auditor shall forward his report to the trustees and such report shall form part of the Annual Report of the mutual fund.

(4) The auditor's report shall comprise the following:—

(a) a certificate to the effect that,—

(i) he has obtained all information and explanations which, to the best of his knowledge and belief, were necessary for the purpose of the audit ;

(ii) the balance sheet and the revenue account give a fair and true view of the scheme, state of affairs and surplus or deficit in the Fund for the accounting period to which the Balance Sheet or, as the case may be, the Revenue Account relates ;

(iii) the statement of account has been prepared in accordance with accounting policies and standards as specified in the Ninth Schedule.

Providing copies of Annual report and summary thereof

56. (1) The scheme wise Annual Report of a mutual fund or an abridged summary thereof shall be provided to all unit holders as soon as may be but not later than four months from the date of closure of the relevant accounts year in the manner specified by the Board.

(2) The Annual Report and abridged summary thereof shall contain details as specified in the Eleventh Schedule and such other details as are necessary for the purpose of providing a true and fair view of the operations of the mutual fund:

Provided that the abridged scheme wise Annual Report provided to the unit holders is in the format prescribed by the Board in this regard.

(3) Notwithstanding anything contained in sub-regulation (1), the mutual fund shall provide physical copy of the abridged summary of the Annual Report without any cost, if a request through any mode is received from a unit holder.

(3A) The report provided in abridged summary form as per sub-regulation (1) shall carry a note that for unit holders of a scheme full Annual Report shall be available for inspection at the Head Office of the mutual fund and a copy thereof shall be made available to unit holder on payment of such nominal fees as may be specified by the mutual fund.

(4) The asset management company shall display the link of the full scheme wise annual reports prominently on their website.

Annual Report to be forwarded to the Board

57. Every mutual fund shall within four months from the date of closure of each financial year forward to the Board a copy of the Annual Report and other information including details of investments and deposits held by the mutual fund so that the entire scheme wise portfolio of the mutual funds is disclosed to the Board.

Periodic and continual disclosures

58. (1) The mutual fund, the asset management company, the trustee, custodian, sponsor of the mutual fund shall make such disclosures or submit such documents as they may be called upon to do so by the Board

(2) Without prejudice to the generality of sub-regulation (1), the mutual fund shall furnish the following periodic reports to the Board, namely:—

(a) copies of the duly audited annual statements of accounts including the balance sheet and the profit and loss account for the fund and in respect of each scheme, once a year;

(b) a copy of six monthly unaudited accounts ;

(c) a quarterly statement of movements in the net assets for each of the schemes of the fund;

(d) a quarterly portfolio statement, including changes from the previous periods, for each scheme.

(3) No sale of units of any scheme of a mutual fund shall be made by the trustees or an asset management company unless accompanied by documents which contain information which is adequate for the investors to take an informed decision.

Half-yearly Disclosures

59. (1) A mutual fund and asset management company shall within one month from the close of each half year, that is on 31st March and on 30th September, host a soft copy of its unaudited financial results on their website:

Provided that the half-yearly unaudited report referred to in this sub-regulation shall contain details as specified in Twelfth Schedule and such other details as are necessary for the purpose of providing a true and fair view of the operations of the mutual fund.

(2) A mutual fund and asset management company shall publish an advertisement disclosing the hosting of such financial results on their website, in at least one English daily newspaper having nationwide circulation and in a newspaper having wide circulation published in the language of the region where the Head Office of the mutual fund is situated.

Statement of Portfolio

59A. A mutual fund shall before the expiry of ten days from the close of each half year (i.e., 31st March and 30th September), send to all unit holders a complete statement of its scheme portfolio, in the manner specified by the Board.

Disclosures to the investors

60. The trustee shall be bound to make such disclosures to the unit holders as are essential in order to keep them informed about any information which may have an adverse bearing on their investments.

CHAPTER VIII

INSPECTION AND AUDIT

Board's right to inspect and investigate

61. (1) The Board may appoint one or more persons as inspecting officer to undertake the inspection of the books of account, records, documents and infrastructure, systems and procedures or to investigate the affairs of a mutual fund, the trustees and asset management company for any of the following purposes, namely :—

(a) to ensure that the books of account are being maintained by the mutual fund, the trustees and asset management company in the manner specified in these regulations;

(b) to ascertain whether the provisions of the Act and these regulations are being complied with by the mutual fund, the trustees and asset management company ;

(c) to ascertain whether the systems, procedures and safeguards followed by the mutual fund are adequate;

(d) to ascertain whether the provisions of the Act or any rules or regulations made thereunder have been violated ;

(e) to investigate into the complaints received from the investors or any other person on any matter having a bearing on the activities of the mutual funds, trustees and asset management company;

(f) to suo motu ensure that the affairs of the mutual fund, trustees or asset management company are being conducted in a manner which is in the interest of the investors or the securities market.

Notice before inspection and investigation

62. (1) Before ordering an inspection or investigation under regulation 61 the Board shall give not less than ten days notice to the mutual fund, asset management company or trustees as the case may be.

(2) Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors no such notice should be given, it may, by an order in writing direct that such inspection or investigation be taken up without such notice.

(3) During the course of inspection or investigation, the mutual fund, trustees or asset management company against whom the inspection or investigation is being carried out shall be bound to discharge his obligations as provided in regulation 63.

Obligations on inspection and investigation

63. (1) It shall be the duty of the mutual fund, trustees or asset management company whose affairs are being inspected or investigated, and of every director, officer and employee thereof, to produce to the inspecting officer such books, accounts, records, and other documents in its custody or control and furnish him such statements and information relating to the activities as mutual funds, trustees or asset management company, as the inspecting officer may require, within such reasonable period as the inspecting officer may specify.

(2) The mutual fund, trustees or asset management company shall allow the inspecting officer to have a reasonable access to the premises occupied by it or by any other person on its behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the mutual fund, trustees and asset management company or such other person and also provide copies of documents or other materials which in the opinion of the inspecting officer are relevant for the purpose of the inspection.

(3) The inspecting officer, in the course of inspection or investigation, shall be entitled to examine or record the statements of any director, officer, or employee of the mutual fund, trustees and asset management company. (4) It shall be the duty of every director, officer, or employee of the mutual fund, asset management company or trustee to give to the inspecting officer all assistance in connection with the inspection or investigation, which the inspecting officer may reasonably require.

Submission of report to the Board

64. The inspecting officer shall, as soon as possible, on completion of the inspection or investigation submit a report to the Board:

Provided that if directed to do so by the Board, he may submit an interim report.

Action on inspection or investigation report

65. The Board or the Chairman shall after consideration of inspection or investigation report take such action as the Board or Chairman may deem fit and appropriate including action under Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Appointment of auditor

66. Without prejudice to the provisions of regulation 55, the Board shall have the power to appoint an auditor to inspect or investigate, as the case may be, into the books of account or the affairs of the mutual fund, trustee or asset management company:

Provided that the Auditor so appointed shall have the same powers of the inspecting officer as stated in regulation 61 and the obligation of the mutual fund, asset management company, trustee, and their respective employees in regulation 63, shall be applicable to the investigation under this regulation.

Payment of inspection fees to the Board

67. The Board shall be entitled to recover such expenses including fees paid to the auditors as may be incurred by it for the purposes of inspecting the books of account, records and documents of the mutual fund, the trustees and the asset management company.

CHAPTER IX

PROCEDURE FOR ACTION IN CASE OF DEFAULT

Liability for action in case of default

68. A mutual fund which—

(a) contravenes any of the provisions of the Act and these regulations;

(b) fails to furnish any information or furnishes wrong information relating to its activity as a mutual fund as required under these regulations;

(c) fails to submit periodical returns as required under these regulations;

(d) does not co-operate in any inquiry or inspection conducted by the Board;

(e) fails to comply with any directions of the Board issued under the provisions of the Act or the regulations;

(f) fails to resolve the complaints of the investors or fails to give a satisfactory reply to the Board in this behalf; (g) indulges in unfair trade practices in securities.

Explanation— For the purposes of this clause "unfair trade practices" has the same meaning as in the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995;

(h) is guilty of misconduct or improper or un businesslike or unprofessional conduct which is not in accordance with the Code of Conduct specified in the Fifth Schedule;

(i) asset management company fails to maintain the net worth in accordance with the provisions of regulation 21;

(j) fails to pay any fees;

(k) violates the conditions of registration;

(l) mutual fund, asset management company or trustees of that mutual fund does not carry out its obligations as specified in these regulations, shall be dealt with in the manner provided under Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

69. to 74. Omitted

Action against intermediaries

75. The Board may initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act who fails to exercise due diligence or to comply with the obligations under these regulations:

Provided that no such certificate of registration shall be suspended or cancelled unless the procedure specified in regulations applicable to such intermediary is complied with.

Action against mutual fund and/or asset management company

75A. Without prejudice to regulation 68, a mutual fund and/or asset management company shall be liable for action under the applicable provisions of the Act and the Regulations framed thereunder,–

(a) in case the advertisement issued is in contravention with the Advertisement Code specified in Sixth Schedule;

(b) in case the valuation of securities is in contravention of the Principles of Fair Valuation specified in Eighth Schedule.

Adjudication, etc.

76. (1) The Board may for the offences specified in sections 15A to 15E of the Act initiate action under section 15-I of the Act and in case of violation of any of the provisions of the Act or the regulations, initiate action under section 11, 11B or section 24 of the Act.

(2) The Board may in addition to suspension or cancellation of certificate, order suspension of launching of any scheme of a mutual fund for a period not exceeding one year for violation of any of the provisions of these regulations after following procedure under this Chapter.

(3) The Board may during the pendency of any proceeding of suspension or cancellation under this Chapter also order suspension for launching of any scheme not exceeding three months without following procedure under this Chapter :

Provided that no order shall be passed without giving an opportunity of hearing.

CHAPTER X

MISCELLANEOUS

Power of the Board to issue clarifications

77. In order to remove any difficulties in the application or interpretation of these regulations, the Board shall have the power to issue clarifications and guidelines in the form of notes or circulars which shall be binding on the sponsor, mutual funds, trustees, asset management companies and custodians.

Repeal and saving

78. (1) The Securities & Exchange Board of India (Mutual Funds) Regulations, 1993 are hereby repealed.

(2) Notwithstanding such repeal :

(a) anything done or any action taken or purported to have been done or taken, including registration or approval granted, fees collected, scheme announced, registration or approval, suspended or cancelled, any inquiry or investigation commenced under the said regulations, shall be deemed to have been done or taken under the corresponding provisions of these regulations ;

(b) any application made to the Board under the said regulations and pending before it shall be deemed to have been made under the corresponding provisions of these regulations ;

(c) any appeals preferred to the Central Government under the said regulations and pending before it shall be deemed to have been preferred under the corresponding provisions of these regulations.