

FUNDAMENTALS OF CAPITAL MARKET

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Introduction to Capital Market

CAPITAL MARKET INSTRUMENTS

- There are mainly two types of instruments which are traded in the capital market, which are:
 1. Stocks: Stocks are sold and bought over a stock exchange, They represent ownership in the company and the buyer of the share is referred as the shareholder.
 2. Bonds: The debt securities which are traded in the capital market are known as the bonds. Companies issue bonds for in order to raise capital for the expansion of the business and growth.

THE MAIN FINANCIAL INTERMEDIARIES OF INDIA INCLUDE:

Stock Exchanges: These include the NSE (National Stock Exchange), BSE (Bombay Stock Exchange), MCX (Multi Commodity Exchange), etc

Banks

Insurance Companies

Pension Funds

Mutual Funds

INDIAN CAPITAL MARKET

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CLASSIFICATION OF CAPITAL MARKET

The capital market in India includes the following institutions (i.e., supply of funds for capital markets comes largely from these); (i) Commercial Banks;

(ii) Insurance Companies (LIC and GIC);

(iii) Specialised financial institutions like IFCI, IDBI, ICICI, SIDCS, SFCS, UTI etc.;

(iv) Provident Fund Societies;

(v) Merchant Banking Agencies;

(vi) Credit Guarantee Corporations.

Individuals who invest directly on their own in securities are also suppliers of fund to the capital market.

- The Indian capital market is divided into gilt-edged market and the industrial securities market.

- The gilt-edged market refers to the market for government and semi-government securities, backed by the RBI.
- The industrial securities market refers to the market for shares and debentures of old and new companies.
- The new issue market refers to the raising of new capital in the form of shares and debentures, whereas the old capital market deals with securities already issued by companies.

GROWTH OF INDIAN CAPITAL MARKET

INDIAN CAPITAL MARKET BEFORE INDEPENDENCE

- Indian capital market was hardly existent in the pre-independence times. Agriculture was the mainstay of economy but there was hardly any long term lending to agricultural sector. Similarly the growth of industrial securities market was very much hampered since there were very few companies and the number of securities traded in the stock exchanges was even smaller.
- Indian capital market was dominated by gilt-edged market for government and semi-government securities. Individual investors were very few in numbers and that too were limited to the affluent classes in the urban and rural areas. Last but not the least, there were no specialised intermediaries and agencies to mobilise the savings of the public and channelise them to investment.

INDIAN CAPITAL MARKET AFTER INDEPENDENCE

- Since independence, the Indian capital market has made widespread growth in all the areas as reflected by increased volume of savings and investments. In 1951, the number of joint stock companies (which is a very important indicator of the growth of capital market) was 28,500 both public limited and private limited companies with a paid up capital of Rs. 775 crore, which in 1990 stood at 50,000 companies with a paid up capital of Rs. 20,000 crore. The rate of growth of investment has been phenomenal in recent years, in keeping with the accelerated tempo of development of the Indian economy under the impetus of the five year plans.

RECENT DEVELOPMENTS IN THE INDIAN CAPITAL MARKET

- 1. New Measures of Risk Management: Investments in Capital Markets are exposed to various risks.
- Circuit Breakers: Circuit breakers were introduced to reduce large sell-offs and panic selling. Sometimes it is also called a “collar”. If an Index or a particular stock rises or falls a certain percentage of 10%, 15% or 20%, trading is halted by the exchange in that stock or index for a certain period of time to curb the panic and check for market manipulations

RECENT DEVELOPMENTS IN THE INDIAN CAPITAL MARKET

- 2. Investor Awareness Campaign: To make the markets more secure for the investors, SEBI introduced the Investor Awareness Campaign by making an official site for this.
- 3. Investigations: In case of any violation of the rules and regulations of the SEBI Act 1992, the investigation is carried out by SEBI.

RECENT DEVELOPMENTS IN THE INDIAN CAPITAL MARKET

- 4. T + 2 Settlement Cycle: Currently in the Indian Capital market, the settlement cycle is in the “T+2” cycle. Here, ‘T’ means the trading day and the ‘T+2’ settlement means the settlement and delivery of the shares takes place in the 2nd trading day after the trade takes place
- 5. Ban on Insider Trading: Individuals possessing confidential information of a particular company can use the information to unethically profit from the stock markets. SEBI has made it clear and mandatory to restrict all kinds of insider trading in the Indian Capital Markets.

ESTABLISHMENT OF REGULATOR:

A major initiative of regulation was, establishment of a statutory autonomous agency, called SEBI, to provide reassurance that it is safe to undertake transactions in securities.

REFORMS AND DEVELOPMENTS IN CAPITAL MARKET SINCE 1991

- 1. Securities and Exchange Board Of India (SEBI)
- SEBI became operational since 1992. It was set with necessary powers to regulate the activities connected with marketing of securities and investments in the stock exchanges, merchant banking, portfolio management, stock brokers and others in India.
- The objective of SEBI is to protect the interest of investors in primary and secondary stock markets in the country.

NATIONAL STOCK EXCHANGE (NSE)

- The setting up to NSE in 1992 is a landmark in Indian capital markets. At present, NSE is the largest stock market and towns across the country.
- Trading on NSE can be done throughout the country through the network of satellite terminals (fully automated screen-based trading system).
- NSE has introduced inter-regional clearing facilities.

DEPOSITORIES ACT:

The earlier settlement system gave rise to settlement risk. This was due to the time taken for settlement and due to the physical movement of paper. Further, the transfer of shares in favour of the purchaser by the company also consumed considerable amount of time. To obviate these problems, the Depositories Act, 1996 was passed to provide for the establishment of depositories in securities.

RISK MANAGEMENT:

A number of measures were taken to manage the risks in the market so that the participants are safe and market integrity is protected. The trading cycle varied from 14 days for specified securities to 30 days for others and settlement took another fortnight. Rolling

settlement on T+5 basis was introduced in phases. All scrips moved to rolling settlement from December 2001. T+5 gave way to T+3 from April 2002 and T+2 from April 2003.

DEMATERIALISATION OF SHARES

- Demat of shares has been introduced in all the shares traded on the secondary stock markets as well as those issued to the public in the primary markets. Even bonds and debentures are allowed in demat form. The advantage of demat trade is that it involves Paperless trading.

CORPORATE GOVERNANCE -

To improve the standards of corporate governance, SEBI amended Clause

49 of the Listing Agreement. The major changes in the new Clause 49 include amendments/additions to provisions relating to definition of independent directors, strengthening the responsibilities of audit committees, improving quality of financial disclosures, including those pertaining to related party transactions and proceeds from public/rights/preferential issues, requiring Boards to adopt formal code

of conduct, requiring CEO/CFO certification of financial statements and improving disclosures to shareholders.

Certain non-mandatory clauses like whistle blower policy

SCREEN BASED TRADING

- The Indian stock exchanges were modernised in 90s, with Computerised Screen Based Trading System (SBTS), It cuts down time, cost, risk of error and fraud and there by leads to improved operational efficiency.
- The trading system also provides complete online market information through various inquiry facilities.

INVESTOR EDUCATION AND PROTECTION FUND (IEPF)

- Investor Protection The Central Government notified the establishment of Investor Education and Protection Fund (IEPF) with effect from 1st Oct. 2001.
- The IEPF shall be credited with amounts in unpaid dividend accounts of companies, application moneys received by companies for allotment of any securities and due for refund, matured deposits and debentures with companies and interest accrued there on, if they have remained unclaimed and unpaid for a period of seven years from the due date of payment.

ROLLING SETTLEMENT

- Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day (T) are settled after certain days (N). This is called T + N rolling settlement. Since April 1, 2002 trades are settled' under T + 3 rolling settlement. In April 2003, the trading cycle has been reduced to T + 2 days. The shortening of trading cycle has reduced undue speculation on stock markets.

GOLD EXCHANGE TRADED FUNDS IN INDIA

Pursuant to the announcement made by the Honourable Finance Minister in his Budget Speech for 2005-06, SEBI appointed a Committee for the introduction of Gold Exchange Traded Fund (GETF) in India.

Based on the recommendations of the said Committee, the SEBI (Mutual Funds) Regulations, 1996 were amended and notification was issued on January 12, 2006 permitting mutual funds to introduce GETFs in India subject to certain investment restrictions.

GRADING OF INITIAL PUBLIC OFFERINGS (IPOS)-

Grading of all IPOs was made mandatory. The grading

would be done by credit rating agencies, registered with SEBI. It would be mandatory to obtain grading

from at least one credit rating agency. The grading would be disclosed in the prospectus, abridged

prospectus and in every advertisement for IPOs.

INTRODUCTION OF FAST TRACK ISSUANCES

To enable compliant listed companies to access Indian primary

market in a time effective manner through follow-on public offerings and rights issues, SEBI introduced fast track issue mechanism. To make the issuance process fast, the earlier requirement of filing draft offer documents was amended and the need to file draft offer documents with SEBI and the stock exchanges was done away with.

EMPOWERMENT OF STOCK EXCHANGES FOR EFFECTIVE REGULATION OF LISTED ENTITIES

- : In order to empower
- the stock exchanges for effective regulations of listed entities, amendments have been notified to the
- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR Regulations) to enable actions such as imposition of fines and suspension of trading by stock exchanges for contravention of ICDR Regulations.

EXTENSION OF THE APPLICABILITY OF BUSINESS RESPONSIBILITY REPORTING REQUIREMENTS :

The applicability of BRR requirements has now been extended to the top 500 listed entities based on market capitalization as on March 31 of every year. Further, as a green initiative, BRRs are permitted to be made available on the websites of the companies with links to the websites being made available in their annual reports.

TRANSPARENCY IN LISTED COMPANIES DIVIDEND DISTRIBUTION POLICIES:

In order to bring in more

transparency with respect to listed companies dividend policies, a new Regulation 43A has been

introduced in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. This requires

the top 500 listed companies (by way of market capitalization) to formulate and disclose their dividend

distribution policies in their annual reports and on their websites.

THE CLEARING CORPORATION OF INDIA LIMITED (CCIL)

- The CCIL was registered in 2001, under the Companies Act, 1956 with the State Bank of India as the Chief Promoter. The CCIL clears all transactions in government securities and repos and also Rupee / US \$ forex spot and forward deals. All trades in government securities below Rs. 20 crores would be mandatorily settled through CCIL, while those above Rs. 20 crores would have the option for settlement through the RBI.

TRADING IN CENTRAL GOVERNMENT SECURITIES

- In order to encourage wider participation of all classes of investors, including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nationwide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

CREDIT RATING AGENCIES

- Various credit rating agencies such as Credit Rating Information services of India Ltd. (CRISIL – 1988), Investment Information and credit Rating Agency of India Ltd. (ICRA – 1991), etc. were set up to meet the emerging needs of capital market. They also help merchant bankers, brokers, regulatory authorities, etc. in discharging their functions related to debt issues.

ACCESSING GLOBAL FUNDS MARKET

- Indian companies are allowed to access global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Further Indian financial system is opened up for investments of foreign funds through Non-Resident Indians (NRIs), Foreign Institutional investors (FIIs), and Overseas Corporate Bodies (OCBs).

MUTUAL FUNDS

- Mutual Funds are an important avenue through which households participate in the securities market. As an investment intermediary, mutual funds offer a variety of services / advantages to small investors. SEBI has the authority to lay down guidelines and supervise and regulate the working of mutual funds.

INTERNET TRADING

- Trading on stock exchanges is allowed through internet, investors can place orders with registered stock brokers through internet. This enables the stock brokers to execute the orders at a greater pace.

BUY BACK OF SHARES

- Since 1999, companies are allowed to buy back of shares. Through buy back, promoters reduce the floating equity stock in market. Buy back of shares help companies to overcome the problem of hostile takeover by rival firms and others.

DERIVATIVES TRADING

- Derivatives trading in equities started in June 2000. At present, there are four equity derivative products in India Stock Futures, Stock Options, Index Futures, and Index Options.
- Derivative trading is permitted on two stock exchanges in India i.e. NSE and BSE. At present in India, derivatives market turnover is more than cash market.

PAN MADE MANDATORY

- In order to strengthen the "Know your client" norms and to have sound audit trail of transactions in securities market, PAN has been made mandatory with effect from January 1, 2007

MARKET REGULATION

- It is important to ensure smooth working of capital market, as it is the arena for the players associated with the economic growth of the country. Various laws have been passed from time to time to meet this objective. The financial market in India was highly segmented until the initiation of reforms in 1992-93 on account of a variety of regulations and administered prices including barriers to entry. The reform process was initiated with the establishment of Securities and Exchange Board of India.

THE MAIN LEGISLATIONS GOVERNING THE CAPITAL MARKET ARE:-

- 1. The SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market.
- 2. The Securities Contracts (Regulation) Act, 1956, SC(R) Act which regulates transactions in securities through control over stock exchanges.
- 3. The Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.
- 4. The Companies Act, 2013, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities and disclosures to be made in public issues.

SEBI ACT, 1992

- The SEBI Act, 1992 establishes SEBI with statutory powers for (a) protecting the interests of investors in securities,
- (b) promoting the development of the securities market, and (c) regulating the securities market.

- Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market.
- It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act.
- It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under.
- SEBI has full autonomy and authority to regulate and develop an orderly securities market.

WHAT IS SEBI

- SEBI stands for Securities and Exchange Board of India. It is a statutory regulatory body that was established by the Government of India in 1992 for protecting the interests of investors investing in securities along with regulating the securities market. SEBI also regulates how the stock market and mutual funds function.

OBJECTIVES OF SEBI

Following are some of the objectives of the SEBI:

- 1. Investor Protection: This is one of the most important objectives of setting up SEBI. It involves protecting the interests of investors by providing guidance and ensuring that the investment done is safe.
- 2. Preventing the fraudulent practices and malpractices which are related to trading and regulation of the activities of the stock exchange
- 3. To develop a code of conduct for the financial intermediaries such as underwriters, brokers, etc.
- 4. To bring professionalism in the working of intermediaries in capital markets (brokers, mutual funds, stock exchanges, demat depositories etc
- To regulate issue of capital and transfer of securities.
- To create a good financial climate, so that companies can raise long term funds through issue of securities (shares and debentures).

FUNCTIONS OF SEBI

SEBI has the following functions • 1. Protective Function

- 2. Regulatory Function
- 3. Development Function

PROTECTIVE FUNCTION:

- The protective function includes the following activities.
 - a. Prohibits insider trading: Insider trading is the act of buying or selling of the securities by the insiders of a company, which includes the directors, employees and promoters.

- b. Check price rigging: Price rigging is the act of causing unnatural fluctuations in the price of securities by either increasing or decreasing the market price of the stocks that leads to unexpected losses for the investors.
- SEBI maintains strict watch in order to prevent such malpractices.
- c. Promoting fair practices: SEBI promotes fair trade practice and works towards prohibiting fraudulent activities related to trading of securities.
- d. Financial education provider: SEBI educates the investors by conducting online and offline sessions that provide information related to market insights and also on money management.

REGULATORY FUNCTION:

- Regulatory functions involve establishment of rules and regulations for the financial intermediaries along with corporates that helps in efficient management of the market.
- The following are some of the regulatory functions.
- a. SEBI has defined the rules and regulations and formed guidelines and code of conduct that should be followed by the corporates as well as the financial intermediaries.
- b. Regulating the process of taking over of a company.
- c. Conducting inquiries and audit of stock exchanges.
- d. Regulates the working of stock brokers, merchant brokers.

DEVELOPMENTAL FUNCTION:

- Developmental function refers to the steps taken by SEBI in order to provide the investors with a knowledge of the trading and market function. The following activities are included as part of developmental function.
- 1. Training of intermediaries who are a part of the security market.
- 2. Introduction of trading through electronic means or through the internet by the help of registered stock brokers.

STRUCTURE OF SEBI

- SEBI board comprises nine members. The Board consists of the following members.
- 1. One Chairman of the board who is appointed by the Central Government of India
- 2. One Board member who is appointed by the Central Bank, that is, the RBI
- 3. Two Board members who are hailing from the Union Ministry of Finance
- 4. Five Board members who are elected by the Central Government of India

THE SECURITIES CONTRACTS (REGULATION) ACT, 1956

- The Securities Contracts (Regulation) Act, 1956 “Act” was enacted in order to prevent undesirable transactions in securities and to regulate the working of stock exchanges in the country. The provision of the Act came into force with effect from 20th February, 1957 with Notification No. SRO 528 dated 16th February, 1957.

REGULATORS OF SECURITIES MARKET

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA),

Department of Company Affairs (DCA),

Reserve Bank of India (RBI) and

Securities and Exchange Board of India (SEBI).

COMPONENTS OF SECURITIES MARKET

Securities – Shares, stocks, scrips, Debentures, Bonds, mutual funds, government securities, derivatives.

It is also going to be applicable on contracts of stock exchange.

When you buy and sell stocks.

Not applicable to government/RBI, As they issue G- SECURITIES.

Local authorities – municipalities.

Corporations set by special law like SEBI.

Any person having transactions with the above entities.

SECURITIES CONTRACTS (REGULATION) ACT, 1956

It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock

exchanges and aims to prevent undesirable transactions in securities.

It gives central government/SEBI regulatory jurisdiction over

(a) stock exchanges through a process of recognition and continued supervision, (b) Contracts in securities, and

(c) listing of securities on stock exchanges

DEPOSITORIES ACT 1996

DEPOSITORIES ACT, 1996

• The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring

free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable (b) dematerializing the securities in the depository mode; and

(c) providing for maintenance of ownership records in a book entry form.

COMPANIES ACT, 2013

The Companies Act, 2013 has replaced the Companies Act, 1956. The Companies Act, 2013 envisage to

strengthen the existing regulatory framework on Corporate Governance. It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and

dividends, supply of annual report and other information.

OVER VIEW OF DEPOSITORY SYSTEM IN INDIA

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.

India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved. The physical form of securities is extinguished and shares or securities are held in an electronic form.

KEY FEATURES OF THE DEPOSITORY SYSTEM IN INDIA

- 1. Multi-Depository System: The depository model adopted in India provides for a competitive multi-depository system. There can be various entities providing depository services. A depository should be a company formed under the Companies Act, 2013 (erstwhile Companies Act, 1956) and should have been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992. Presently, there are two depositories registered with SEBI, namely:

- – National Securities Depository Limited (NSDL), and
- – Central Depository Service Limited (CDSL)

2. DEPOSITORY SERVICES THROUGH DEPOSITORY PARTICIPANTS

- The depositories can provide their services to investors through their agents called depository participants.
- These agents are appointed subject to the conditions prescribed under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and other applicable conditions

3. DEMATERIALISATION

- The model adopted in India provides for dematerialisation of securities. This is a significant step in the direction of achieving a completely paper-free securities market. Dematerialization is a process by which physical certificates of an investor are converted into electronic form and credited to the account of the depository participant.

4. FUNGIBILITY

- The securities held in dematerialized form do not bear any notable feature like distinctive number, folio number or certificate number.
- Once shares get dematerialized, they lose their identity in terms of share certificate, distinctive numbers and folio numbers.
- Thus, all securities in the same class are identical and interchangeable.
- For example, all equity shares in the class of fully paid-up shares are interchangeable

5. REGISTERED OWNER/ BENEFICIAL OWNER

- In the depository system, the ownership of securities dematerialized is bifurcated between Registered

Owner and Beneficial Owner.

- According to the Depositories Act, 1996 'Registered Owner' means a depository whose name is

entered as such in the register of the issuer. A 'Beneficial Owner' means a person whose name is

recorded as such with the depository. Though the securities are registered in the name of the depository actually holding them, the rights, benefits and liabilities in respect of the securities held by the

depository remains with the beneficial owner.

- For the securities dematerialized, NSDL/CDSL is the Registered Owner in the books of the issuer; but

ownership rights and liabilities rest with Beneficial Owner.

- All the rights, duties and liabilities underlying the security are on the beneficial owner of the security.

6. FREE TRANSFERABILITY OF SHARES

- Transfer of shares held in dematerialized form takes place freely through electronic book-entry system.

FEATURES OF DEVELOPED CAPITAL MARKET: THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO)

- The International Organization of Securities Commissions (IOSCO) was created in 1983 with the decision to change from an inter-American regional association (created in 1974) into a global cooperative body. Eleven securities regulatory agencies from North and South America took this decision in April 1983 at a meeting in Quito, Ecuador.

IOSCO

- In 1984, securities regulators from France, Indonesia, Korea and the United Kingdom were the first agencies to join the organization from outside the Americas.
- The IOSCO Annual Conference in July 1986, held in Paris, was the first to take place outside.
- It was decided at this meeting to create a permanent General Secretariat for IOSCO.

IOSCO

- Today IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies.
- IOSCO members are drawn from, and regulate, over 100 jurisdictions and its membership continues to grow.

IOSCO OBJECTIVE OF SECURITIES REGULATION

- There are three objectives of securities regulation –
 - (i) protecting investors;
 - (ii) ensuring that markets are fair, efficient and transparent;

- (iii) reducing systemic risk

MEMBERSHIP

- There are three categories of membership within IOSCO which are designed to the different approaches to securities markets regulation while also ensuring that those with an interest in the regulation of securities markets is also involved in the debate on securities market issues.
- The three categories are:
 - – Ordinary;
 - – Associate; and
 - – Affiliate.

ORDINARY

- This category is open to a securities commission, or a similar government or statutory regulatory body that has primary responsibility for securities regulation in its jurisdiction.
- If there is no governmental, or statutory, regulatory body in a jurisdiction then a self-regulatory body, such as a stock exchange, in that jurisdiction is eligible for ordinary membership of IOSCO. However, the ordinary membership of a self-regulatory body admitted to IOSCO will lapse if a governmental regulatory body from the same jurisdiction becomes the ordinary member for that jurisdiction.
- Ordinary members each have one vote in the Presidents Committee, which meets yearly at the Annual Conference

ASSOCIATE

- The following bodies can apply to become associate members of the organization:
 - a public regulatory body with jurisdiction in the subdivisions of a jurisdiction if the national regulatory body is already an ordinary member; and any other eligible body with

an appropriate responsibility for securities regulation.

- A self-regulatory body is not eligible for associate membership.
- Associate members do not have the right to vote and also don't have a membership of the IOSCO Board; however, they are members of the Presidents Committee
- SROs are not allowed as associate members.

AFFILIATE

- A self-regulatory body (SRO), or an international body, with an appropriate interest in securities regulation is eligible for this category of membership.
- Affiliate members do not have a vote, are not eligible for the IOSCO Board and are not members of the Presidents Committee. SROs affiliate members form the SRO Consultative Committee

EQUITY SHARES

Equity shares, commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holder of such shares are the member of the company and has voting rights.

IMPORTANT CHARACTERISTICS OF EQUITY SHARES ARE
GIVEN BELOW:

- Equity shares, have voting rights at all general meetings of the company. These votes have the effect of
the
- controlling the management of the company.
- Equity shares have the right to share the profits of the company in the form of dividend (cash) and bonus
shares.

- However even equity shareholders cannot demand declaration of dividend by the company which is left

to the discretion of the Board of Directors.

- When the company is wound up, payment towards the equity share capital will be made to the

respective shareholders only after payment of the claims of all the creditors and the preference share

capital

EQUITY SHARE HOLDERS ENJOY DIFFERENT RIGHTS AS MEMBERS UNDER THE COMPANIES ACT, 2013 SUCH AS

- The right to vote on every resolution placed before the company – (Section 47)
- The rights to subscribe to shares at the time of further issue of capital by the company – (Section 62)
- Right to appoint proxy to attend and vote at the meeting on his behalf – (Section 105)
- Right to receive copy of annual accounts of the company – (Section 136)
- Right to receive notice of the meeting of members – (Section 101)

DIFFERENCE BETWEEN PREFERENCE AND EQUITY SHARES

Parameters	Preference Share	Equity Share
Dividend Rate	Has a fixed rate	Fluctuates
Vote Rights	No voting rights	Have voting rights
Participation in Management	Has no right to participate in	
	management decision	
		Has the right to participate in
		management decision

Preferences Get the first preference, before

equity share

Gets second preference, after

preference share

PREFERENCE SHARES

- According to explanation (ii) to Section 43 of Companies Act, 2013 “preference share capital”,

with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to –

- (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which

may either be free of or subject to income-tax; and

- (b) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum

or articles of the company;

PARTICIPATING PREFERENCE SHARES

Preference shareholders are not entitled to dividend more than what has been indicated as part of the terms of issue, even in a year in which the company has made huge profits.

Subject to provision in the terms of issue these shares can be entitled to participate in the surplus profits left, after payment of dividend to the preference and the equity shareholders to the extent provided therein.

Subject to provisions in the terms of issue such preference shares can be entitled even to

bonus shares.

NON-PARTICIPATING PREFERENCE SHARES

- Unless the terms of issue indicate specifically otherwise, all preference shares are to be regarded as nonparticipating preference shares.

CUMULATIVE PREFERENCE SHARES

- Cumulative preference shares where the preference dividend gets accumulated for being paid subsequently if the company does not have adequate profits. Such arrears of dividend need to be paid in subsequent years before payment of equity dividends.

NON-CUMULATIVE PREFERENCE SHARES

- In the case of these preference shares, dividend does not accumulate. If there are no profits or the profits are inadequate in any year, the shares are not entitled to any dividend for that year. Unless there is a specific provision in the Articles of Association of the company, the preference shareholders have no right to participate in the surplus profits or in the surplus assets in a winding up.

CONVERTIBLE PREFERENCE SHARES

- If the terms of issue of preference shares includes a right for converting them into equity shares at the end of a specified period they are called convertible preference shares. In the absence of such condition or right, the preference shares are not converted into

equity shares to become eligible for various rights such as voting, higher dividend, bonus issue etc. as in the case of equity shares.

- These shares are sometimes referred to as quasi equity shares in common parlance

REDEEMABLE PREFERENCE SHARES

- These are such preference shares in which are redeemed after specific period and money is returned to shareholders. According to Section 55 of the Companies Act, 2013, a Company cannot issue preference shares which are irredeemable. If Article of association permits, the Company can issue preference shares which are redeemable not later than 20 years. Companies engaged in infrastructure projects can issue shares redeemable exceeding 20 years subject to condition mentioned in rule 9 and 10 of the Companies (Share Capital and Debenture) Rules, 2014.

DEBENTURES

- Debenture is a document issued by the company to raise finance as a debt and use that finance for business operations,
- Debenture is a document evidencing a debt or acknowledging it and any document which fulfils either of these conditions is a debenture.

THE IMPORTANT FEATURES OF A DEBENTURE ARE:

1. It is a written document
2. It is issued by a company as a certificate of indebtedness.
3. It usually indicates the date of redemption and also provides for the repayment of principal and payment of interest at specified date or dates.
4. It usually creates a charge on the undertaking or the assets of the company.
5. Debenture's holders does not have any voting rights.

6. Compulsory payment of interest. The interest on debenture is payable irrespective of whether there are

profits made or not

TYPES OF DEBENTURES

- Security
- Redemption
- Registration
- convertibility

TYPES OF DEBENTURES

• Secured debentures - those debentures which are secured by creating a charge over the assets of the company is called as secured debentures.

• unsecured debentures – those debentures which are not secured by creating a charge over the assets of the company is called as unsecured debentures.

TYPES OF DEBENTURES

- Redemption debentures – redemption means repayment
- Those debentures which are repaid after a fixed time period is called redeemable debentures
- Irredeemable Debentures – those debentures which are not repaid during the life of a company. They are repaid at the time of liquidation of the company.

TYPES OF DEBENTURES

- Registered debentures
- Those debentures which are registered in the records of the company. In such a case principal amount and interest is paid to the registered debenture holder only.

TYPES OF DEBENTURES

- Bearer Debentures
- Also called as unregistered debentures
- Those debentures which are not registered in the records of the company.
- These debentures can be transferred from one to another.
- Amount is payable to the holder of the holder of the debentures

TYPES OF DEBENTURES

- CONVERTIBILITY – those debentures which can be converted into shares.
- If the company doesn't have money to repay then they will give option to debenture holders to get the shares of the company.
- NON- CONVERTIBILITY -
- those debentures which cannot be converted into shares.

SWEAT EQUITY

COMMON SHARES

- In general, common shares provides voting rights in shareholders meeting and rights to receive annual dividend and to bear any inherent liabilities. Any share with voting rights represents one vote in shareholders meeting (one share one vote). In the event of the shareholders cannot attend to the meeting, they can be represented by their proxies including to attend, to discuss and to cast vote on behalf of the authorizer.

NON-VOTING SHARES

- Other type of shares is shares with limited authority. Holder of this shares is entitled to receive dividend, but not to cast vote in shareholders meeting. It is commonly known as non-voting shares.

WHAT IS A SHARE WARRANT?

- Definition:
- Share Warrant is a document which is issued by a Public Listed Company (PLC) under its common seal, stating that the bearer of this document is entitled to the shares or stock as specified in the warrant. Without registration, share warrant can be transferred to another person.
- Share warrant is a negotiable instrument and mere delivery the transfers the ownership of the shares. In the document (Share warrant), the name of the shareholders is not mentioned, and the coupon rate is attached to the warrant and the date of dividend payment will be mentioned

CONDITIONS FOR ISSUING SHARE WARRANTS

- The following conditions should be satisfied for issuing share warrants.
- 1. Only a public company can issue share warrants.
- 2. It must be authorized by the Articles of Association.

- 3. The shares must be fully paid-up.
- 4. The approval of the Central Government is necessary.

ADVANTAGES OF SHARE WARRANT

- Share mentioned in the share warrant can be transferred by share warrant exchange.
- Transferred by mere delivery without any registration.
- It is negotiable instrument.
- The bank accepts share warrant as a security of the loans.
- Future dividends can be provided by attaching dividend coupons with the share warrants

DISADVANTAGES/LIMITATIONS OF SHARE WARRANT

- Besides advantages share warrant has some limitations which are enumerated as below:
- Not so popular in India
- Bearer is not the member of the company
- The Bearer will be considered as the owner of the warrant, but sometimes it can be lost by the real owner.
- The Company may not be careful in case of printing and keeping the warrant safe.
- The stamp duty is higher
- Prior approval of the Government is needed
- Number of shares is mentioned in the warrant, is not sufficient for being a partner of the company's directorship.

DIFFERENCE BETWEEN SHARE WARRANT AND SHARE CERTIFICATE

Share warrant

Issued by only public company

Share warrant is a bearer document

It is a negotiable document

Issued only on fully paid-up capital

Share certificate

Issued by public and private company

It is not a bearer document

It is not a negotiable document

Issued on fully paid up as well as partly paid
up shares

WHAT IS CALL AND PUT OPTIONS?

- Options can be defined as contracts that give a buyer the right to buy or sell the underlying asset, or the security on which a derivative contract is based, by a set expiration date at a specific price.
- A call option is bought if the trader expects the price of the underlying to rise within a certain time frame.
- A put option is bought if the trader expects the price of the underlying to fall within a certain time frame.

HOW CALL OPTIONS WORK

- For U.S.-style options, a call is an options contract that gives the buyer the right to buy the underlying asset at a set price at any time up to the expiration date.²
- Buyers of European-style options may exercise the option— to buy the underlying—only on the expiration date. Options expirations vary and can be short-term or long-term.

HOW PUT OPTIONS WORK

- Put options are the opposite of call options. For U.S.-style options, a put options contract

gives the buyer the right to sell the underlying asset at a set price at any time up to the expiration date.

- Buyers of European-style options may exercise the option—sell the underlying—only on the expiration dates.

WHAT ARE HYBRID SECURITIES?

- Hybrid Securities are financial instruments that have mixed characteristics of two or more different financial instruments like stocks or bonds. These are defined under Section 2 (19A) of the Companies Act, 1956 as “any security which has the character of more than one type of security, including them derivatives” These are hence called as ‘hybrids’ because they have mixed characteristics of both equity and debt.
- The Supreme Court dealt with the issue of whether ‘hybrid’ securities are ‘securities’ as per the scheme of the Companies Act and SEBI Act in the case of Sahara India Real Estate Corporation Limited & Ors. v. SEBI

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF USING HYBRID SECURITIES?

- Advantages

1. Higher yield: Hybrid securities are generally placed subordinate in the capital structure and hence

offer a high rate of return than senior debt.

2. Less volatility in market price: Hybrid securities have less volatility in the market because they pay a

regular, pre-determined, distribution of market returns.

3. Diverse nature: Hybrid securities are, as mentioned above, not bound by any strict definition of

either equitable securities or debt securities and hence can diversify the overall risk portfolio while

again, guaranteeing attractive returns and hence, improving a firm’s risk profile.

- Disadvantages
- Complicated: Investing through hybrid securities is considered more complicated than investing through equity or bond securities

WHAT ARE THE DIFFERENT TYPES OF HYBRID SECURITIES AND WHAT ARE THEIR FEATURES?

1. Convertible Bond
2. Preferred Shares
3. Mezzanine Financing
4. Toggle Notes
5. Warrants

CONVERTIBLE BOND

- A convertible bond is a type of security that gives the investors a bond along with the power to convert that bond into stocks of the same company. It is a type of hybrid security because its nature as a bond makes it debt security while this nature changes into equity security when it is converted into a company's share.
- To determine when it will be beneficial for investors to convert their bonds into stocks a conversion price is used. If the price of common shares is lower than the conversion price then it is not beneficial for the investor to convert, however, in an opposite situation where the company is earning a lot of profit and its price of common share is more than the conversion price then it is profitable for the investors to convert the bond into common shares and sell them.

PREFERRED SHARES

- Also called preference stocks, these are shares of a company that are paid before the common shares of a

company in case of bankruptcy.

- Preferred shares are hybrid shares because they possess features of both equity and bonds.
- Like equity, preference shares
- Pay dividends, don't have a maturity period, under certain circumstances, may give shareholders a right to

vote.

- Like bonds, preference shares
- Require the company to make regular, pre-set payments, do not carry voting right, generally, for investors
- Don't grant a claim on the company's profits
- Receive credit ratings and their market price is also determined by the credit ratings and direction of interest

rates.

MEZZANINE FINANCING

- It is a type of security that involves both equity and bond like features and combines both to give effect of a hybrid security. It is a kind of security in which a loan is given to the company by the lender, however, the lender can assume ownership position through acquisition of shares if there is a default on loan by the company. This again, helps the lender to have secured payment through the loan and in case of default, gives the lender an equity in the company.

TOGGLE NOTES

- It is a kind of debt security that gives the company an option to defer payments in exchange for a higher rate of interest.
- Toggle notes are like bonds in nature, and functioning. They mandate the company to pay interest, and they are a way of borrowing from public by the company just like a traditional bond, however, when it comes to a difference

between them and a traditional bond, toggle notes provide the company an option to defer a payment in situations when it suffers from a temporal cash-flow problems in lieu of a higher rate of interest and make the payment at a later date when the temporary cash-flow problem subsides. This helps the company avoid a default in payment and avoid the temporary cash-flow problem.

WARRANTS

- These are a kind of security that give the investors a right to buy or sell shares at a particular price on or before a particular date but does not obligate him to do the same.
- They are just like call options in their functioning but have some minute differences between them. Firstly, while options are bought/sold between investors, warrants are bought/sold between investors and the company issuing the warrant. Secondly, warrants have a longer life than options, so while an option will have a life of 2-3 years, warrants will have a life of 10-15 years. Thirdly, warrants are cheaper than option in general, which means more number of shares for the same number of prices.

Market Instruments for Capital market

STOCK BROKERS

- Is a member of a recognized stock exchange who buys, sells or deals in securities. As a member of stock exchange, will have to abide by its rules, regulations, bye-laws, pay the fee, and take steps for addressing investors grievances.

- The SEBI has defined “stock broker means a member of the stock exchange”

A stock broker means a person having trading rights in any recognized stock exchange including a

trading member.

A certificate of registration is mandatory from the SEBI to act as a broker.

REGISTRATION

- Registration: has to apply through the stock exchange where is a member, who then forwards to SEBI within 30 days of its receipt.

- Conditions for registration

1 Stock broker is eligible to be a member of stock exchange

2 necessary infrastructures

3 past experience

4 disciplinary action in past

Fit and proper person.

- Fees: registration fee on the annual turnover to be paid to SEBI. Annual Turnover up to Rs. 1 crore, Rs.5000,

- Annual turnover in excess of 1 crore, Rs.5000+one hundredth of 1%of the turnover in excess of Rs.1 crore for each financial year.

CODE OF CONDUCT

- Maintain high standard of integrity and fairness.

- Not indulge in manipulative transactions

- Should not create a false market

- Abide all provisions of SEBI

DUTIES OF A BROKER

- FAITHFULLY EXECUTE THE ORDERS
- SHOULDN'T DISCLOSE CONFIDENTIAL INFORMATION OF CLIENT
- SHOULDN'T GIVE FALSE OR MISLEADING INFORMATIONS.
- AVOID DEALING WITH A CLIENT WHO HAS FAILED HIS COMMITMENT WITH ANOTHER STOCKBROKER
- PROVIDE INVESTMENT ADVICE
- SHOULD HAVE ADEQUATELY TRAINED STAFF

STOCK BROKERS REGULATORY FRAMEWORK

GENERAL OBLIGATIONS AND RESPONSIBILITIES:

-

- has to maintain books of accounts, records w.r.t.
- a) Register of Transactions
- b) Documents register containing records relating to receipt/delivery of securities in physical form and those provided by depository participant.
- C) Journals
- d) Cash book
- e) Member's contract book - Member's contract book showing details of contract's entered into with him,
- f) Margin Deposit book
- g) Registers of sub broker accounts etc. Has to appoint compliance officer who will inspect all compliances of SEBI

guidelines and report independently to SEBI. A stock broker not allowed to deal with a sub broker, who is not registered with

SEBI.

LIABILITY FOR CONTRAVENTION OF THE SEBI

ACT

- – monetary penalty under chapter VI-A of SEBI. - Penalties as specified by SEBI, including suspension

or cancellation of Registration.

- Prosecution under section 24 of the SEBI Act. (market manipulation, dealing without registration etc.,

dealing outside recognized stock exchange.)

- Capital Adequacy Norms for Brokers -Base minimum capital -: a min. of Rs.5 lakhs as deposit with

stock exchange by members of Mumbai and Kolkata. Rs.3.5 lakh for Delhi and A' bad stock exchange

members. For other stock exchange members Rs. 2 lakhs minimum. –

- The security deposit forms part of base minimum capital. - 25% of base minimum capital to be kept in

cash with the exchange. Another 25% as long-term fixed deposit(min3yrs) with a bank, whose lien is

given to the stock exchange. The remaining requirement to be maintained as securities. -The securities to

be pledged with the stock exchange.

- Sub brokers: acts on behalf of the stockbroker as an agent for assisting investors in buying and

selling of securities. - not a member of stock exchange, but registered with SEBI. Separate registration with SEBI, for sub broking contract for each broker. Compliance includes payment of

fees, adequate steps for redressal of investor grievances and reporting of the same to SEBI.

- Foreign Brokers: Foreign stock exchange registered brokers, who assist the FIIs to buy and sell

securities in the Indian stock exchange. Registered with SEBI

SUB BROKER

ELIGIBILITY FOR REGISTRATION AS SUB

BROKER

- stock exchange on receipt of an application shall verify the information contained therein and shall also certify that the

applicant is eligible for registration as per criteria specified below:

- (1) In the case of an individual:(a) the applicant is not less than 21 years of age;
- (b) the applicant has not been convicted of any offence involving fraud or dishonesty;
- (c) the applicant has at least passed 12th standard equivalent examination from an Institution recognized by the Government.

However, SEBI may relax this criterion on merits having regard to the applicant's experience;

- (d) the applicant is a fit and proper person.
- (2) In the case of partnership firm or a body corporate, the partners or directors as the case may be shall comply with the

requirements stated above. It is also to be assessed whether the applicant has necessary infrastructure like adequate office

space, equipment and manpower to effectively discharge his activities. The applicant should be person recognized by the

stock exchange as a sub-broker affiliated to a member broker of the stock exchange. The stock exchange shall forward the

application form of such applicants, along with recommendation letter issued by the stock broker with whom he is affiliated

along with a recognition letter issued by the stock exchange to SEBI within 30 days from the date of its receipt.

CONDITIONS OF REGISTRATION

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

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

- (b) he shall pay fees charged by SEBI;

- (c) he shall take adequate steps for redressal of grievances, of the investors within one month of the date of receipt of the complaint and

keep SEBI informed about the number, nature and other particulars of the complaints received from such investors; and

- (d) he is authorized in writing by a stock-broker being a member of a stock exchange for affiliating himself in buying, selling or dealing in

securities.

- The sub-broker has the following general obligations. (a) pay the fees;

- (b) abide by the Code of Conduct specified;

- (c) enter into an agreement with the stock broker for specifying the scope of his authority and responsibilities;

- (d) comply with the rules, regulations and bye laws of the stock exchange;

- (e) the sub-broker shall keep and maintain the books and documents specified in the Regulations.

DUTY TO THE INVESTORS

- Sub-broker has duties toward the investors such as:

- faithful execution of orders of purchase and sale of securities

- maintain confidentiality,

- not to give false or misleading advice,

- ensure no conflict of interest,

- not to give advice about securities in public media without disclosing his interest.

- He should have adequately trained staff and arrangements to render fair, prompt and competent services

to his clients.

- He has to ensure continuous compliance with the regulatory system.

TRADING AND CLEARING/ SELF CLEARING

MEMBERS

- A certificate of registration should be obtained from SEBI to act as a clearing member. However, any SEBI-registered broker who acts as clearing member with the approval of the clearing corporation would not require a separate registration. Similarly, a separate registration would not be required for a SEBI-registered clearing member to operate in more than one clearing corporation.
- A clearing/self-clearing member would pay required fees and satisfy the minimum net worth and deposit requirement for the segment for which membership is sought.
- The provisions relating to general obligations/responsibilities applicable to brokers would apply to clearing/self-clearing members.

STOCK TRADING

- The act of buying and selling of securities on a stock exchange is known as stock market trading

STEPS IN STOCK TRADING

- Following are the steps involved in the trading of securities at a stock exchange.
- 1. Order Placing: The first step in the trading of securities is placement of an order by an investor with the broker either to buy or sell certain number of shares at a certain specified price.
- There are various kinds of orders. For instance, where in an order, the client places a limit on the price of the security; it is a case of 'limit order'. Where the order is to be executed by the broker at the best price, such an order takes the name of 'Best Rate Order'.

- An 'Immediate or Cancel Order' is one that has to be executed immediately and may have to be cancelled if the

order is not executed immediately.

- A Limited Discretionary Order allows the broker to buy and sell within the specified price range and/or within the

given time period as per the best judgement of the broker. Where the client orders the broker to sell as the price

reaches a particular level, it is a case of 'Stop Loss Order'. Under the 'Open Order', the client does not fix any price

limit or time limit on the execution of the order and relies on the judgement of the broker.

STEPS IN STOCK TRADING

- 2. Order Execution: Broker executes the orders placed by the client for the purchase or sale of

scripts. The execution takes place during the trading hours and during the working days of the exchange online.

- 3. Contract Note Preparation: When an agreement is reached between the parties concerned as

regards price, a contract note is made out between the broker and the client. Particulars such as

the price, number of scripts, date of transaction, names of party, brokerage, etc. are shown on Contract Note.

- 4. Delivery and Clearing: Delivery and clearing of share takes place through a clearance house.

STEPS IN STOCK TRADING

- 5. Demat Account Credit and Debit: For the purpose of effecting the transfer in the name of the

transferee, the parties accounts are either debited or credited.

- 6. settlement: Settlement is the process of netting of transactions and actual delivery or receipt of

securities against receipts of payment of agreed amounts. It is necessary to make a settlement to

know the net effect of a series of transactions during a given period.

TYPES OF SECURITIES

- Listed cleared Securities
- The securities of companies, which have signed the listing agreement with a stock exchange, are traded as “Listed Securities” in that exchange. The securities admitted for dealing on stock exchange after complying with all the listing requirements and displayed by board on the list of cleared securities.

- Permitted Securities
- To facilitate the market participants to trade in securities of such companies, which are actively traded at other stock exchanges in India but are not listed on an exchange, trading in such securities is facilitated as “permitted securities” provided they meet the relevant norms specified by the stock exchange.

TYPES OF DELIVERY

- Types of delivery in the stock exchanges are spot delivery, hand delivery and special delivery.
- Spot Delivery Where the delivery of and payment for securities are to be made on the same day

as the day of contract or on the next day.

- Hand Delivery Where the delivery of and payment are to be made on the delivery date fixed by

the stock exchange authorities.

- Special Delivery Where delivery and payment made after the delivery date fixed by the stock

exchange authorities.

DEFINITION OF 'MARGIN TRADING'

Definition: In the stock market, margin trading refers to the process whereby individual investors

buy more stocks than they can afford to. Margin trading also refers to intraday trading in India and

various stock brokers provide this service. Margin trading involves buying and selling of securities

in one single session. Over time, various brokerages have relaxed the approach on time duration.

The process requires an investor to speculate or guess the stock movement in a particular session.

Margin trading is an easy way of making a fast buck. With the advent of electronic stock exchanges, the once specialized field is now accessible to even small traders.

- Description: The process is fairly simple. A margin account provides you the resources to buy more quantities of a stock than you can

afford at any point of time. For this purpose, the broker would lend the money to buy shares and keep them as collateral.

In order to trade with a margin account, you are first required to place a request with your broker to open a margin account. This requires

you to pay a certain amount of money upfront to the broker in cash, which is called the minimum margin. This would help the broker

recover some money by squaring off, should the trader lose the bet and fail to recuperate the money.

Once the account is open, you are required to pay an initial margin (IM), which is a certain percentage of the total traded value

pre-determined by the broker. Before you start trading, you need to remember three important steps. First, you need to maintain the

minimum margin (MM) through the session, because on a very volatile day, the stock price can fall more than one had anticipated.

- For example, if a Tata Steel stock priced at Rs 400 falls 4.25 per cent and the IM and MM are 8 per cent and 4 per

cent of the total value of the shares bought, respectively, then the trade-off $8\% - 4.25\% = 3.75\%$ will be less than the

MM. In this case, you will either have to give more money to the broker to maintain the margin or the trade will

get squared off automatically by the broker.

Secondly, you need to square off your position at the end of every trading session. If you have bought shares, you

have to sell them. And if you have sold shares, you will have to buy them at the end of the session.

Thirdly, convert it into a delivery order after trade, in which case you will have to keep the cash ready to buy all

the shares you had bought during the session and to pay the broker's fees and additional charges.

If even one of these steps is missed, the broker will automatically square off the position in the market

FUNCTIONS OF STOCK

EXCHANGE OF INDIA

- (i) Raising Capital for Business:
 - The Stock Exchange provides companies with the facility to raise capital for expansion through selling shares to the investing public.
- (ii) Mobilizing Savings for Investment:
 - When people draw their savings and invest in shares, it leads to a more rational

allocation of resources because funds, which could have been consumed, or kept in idle deposits with banks, are mobilized and redirected to promote business activity with benefits for several economic sectors such as agriculture, commerce and industry, resulting in a stronger economic growth and higher productivity levels.

(III) FACILITATE COMPANY GROWTH:

- Companies view acquisitions as an opportunity to expand product lines, increase distribution channels, hedge against volatility, increase its market share, or acquire other necessary business assets. A takeover bid or a merger agreement through the stock market is one of the simplest and most common ways to company growing by acquisition of fusion.

(IV) REDISTRIBUTION OF WEALTH:

- By giving a wide spectrum of people a chance to buy shares and therefore become part owners (shareholders) of profitable enterprises, the stock market helps to reduce large income inequalities. Both casual and professional stock investors through stock price rise and dividends get a chance to share in the profits of promising business that were set up by other people.

(V) CORPORATE GOVERNANCE:

- By having a wide and varied scope of owners, companies generally tend to improve on their management standards and efficiency in order to satisfy the demands of these shareholders and the more stringent rules for public corporations by public stock exchanges and the government.

(VI) CREATES INVESTMENT OPPORTUNITIES

FOR SMALL INVESTORS:

- As opposed to other businesses that require huge capital outlay, investing in shares is open to both the large and small stock investors because a person buys the number of shares they can afford. Therefore, the Stock Exchange provides an extra source of income to small savers.

(VII) GOVERNMENT RAISES CAPITAL FOR

DEVELOPMENT PROJECTS:

- Governments at various levels may decide to borrow money in order to finance infrastructure projects such as sewage and water treatment work or housing estates by selling another category of securities known as bonds. These bonds can be raised through the Stock Exchange whereby members of the public buy them, thus loaning money to the government.

(VIII) BAROMETER OF THE ECONOMY:

- At the stock exchange, share prices rise and fall depending, largely, on market forces. Share prices tend to rise or remain stable when companies and the economy in general show signs of stability and growth. An economic recession, depression, or financial crisis could eventually lead to a stock market crash. Therefore, the movement of share prices and in general, of the stock indexes can be an indicator of the general trend in the economy.

TRADING OF PARTLY PAID SHARES AND

DEBENTURES

- Companies fix the last date for payment of allotment or call money in case of partly paid shares

or debentures and intimate this to all the stock exchanges wherein such shares or debentures are

listed. Based on the date fixed by the company, the stock exchanges determine the settlement date

up to which transactions in the scrip will be deemed to be good for delivery. After the said date,

transactions in the securities take place only if they are paid up to the extent money has been called up.

TREND LINE

- When the price of shares moves in a particular direction which persists for a period of time, a

price line is regarded as established. When the movement is upward, the trend is called 'BULLISH' and when the movement is downward it is called 'BEARISH'.

- Bear market is a weak or falling market characterized by the dominance of sellers. Whereas Bull

market is a rising market with abundance of buyers and relatively few sellers.

- Secondary movements that reverse the uptrend temporarily are known as reactions. The movements that reverse the down trend temporarily are known as rallies. When an uptrend break

in the downward direction, it is called trend reversal.

TRADING VOLUME

- Trading volumes confirm whether the rise or fall in prices is in line with the trend. The high trading volume is built on rising prices, similarly the high trading volume is also linked with fall

in prices. They respectively reflect a BULLISH trend and a BEARISH trend.

TURNOVER AND OUTSTANDING POSITION

- The net turnover and outstanding positions in various scrips show the extent of BULLISH interest in them and are used along with trading volume to judge the intensity of the phase whether BULLISH or BEARISH.
- In a BULL phase there will be a sharp rise in the daily turnover of key scrips and in a BEAR phase the reverse will be the case.

MARKET MAKING

- Market making is a process where the market makers offer a two-way quote (both buy and sell) to increase the supply and demand of the scrip. This increases the liquidity in the stock.
- Market-making is aimed at infusing liquidity in securities that are not frequently traded on stock exchanges. A market-maker is responsible for enhancing the demand supply situation in securities such as stocks and futures & options (F&O)
- To understand this concept better, it would be helpful to have an idea about the existing screen based electronic trading system. In this system, orders placed by buyers and sellers are matched by a computer system (run by stock exchanges)
- This system is beneficial for actively-traded stocks, but not for lesser-traded ones. Investors usually ignore thinly-traded stocks despite good fundamentals due to fears that they might not be able to trade more frequently in them. The introduction of the market-making facility could be a possible means to infuse liquidity into such shares. In overseas markets, a market-maker is usually, a broker or an institution. As a result, there is an incentive for the broker to recommend securities for which he creates a market

SECURITIES LENDING

Securities lending is the practice of loaning shares of stock, commodities, derivatives contract, or other

securities to other investors or firms. Securities lending requires the borrower to put up collateral,

whether cash, other securities, or a letter of credit.

- When a security is loaned, the title and the ownership are also transferred to the borrower. A Loan fee,

or borrow fee, is charged by a brokerage to a client for borrowing shares, along with any interest due

related to the loan. The loan fee and interest are charged pursuant to a Securities Lending Agreement

that must be completed before the stock is borrowed by a client. Holders of securities that are loaned

receive a rebate from their brokerage.

- Securities lending provides liquidity to markets, can generate additional interest income for long-term holders of securities, and allows for short-selling.

EXAMPLE OF SECURITIES LENDING

- Suppose an investor believes that the price of a stock will fall from its current price of \$100 to

\$75 in the near future. The stock is not very volatile and generally trades in defined ranges. In order to profit from this thesis, the investor borrows 50 shares of the company from a securities firm and sells them for \$5,000 (50 shares x \$100 current price).

- Assuming the share price drops to \$75, the investor will then purchase 50 shares for \$3,750 (50

shares x \$75 price) and return them to the securities firm. In this case, the profit on this short-sale transaction is \$1,250 (\$5,000 - \$3,750). However, short-sales do not always work out

as planned. If the investor has miscalculated and the company's shares end up increasing in price rather than decreasing, the investor will have to purchase the stock back at a higher

price than the price at which they sold it and will incur a loss on this transaction

SECURITIES' LENDING AND BORROWING ('SLB')

- Securities' Lending and Borrowing ('SLB') describes the market practice whereby securities are temporarily transferred by one party (the lender) to another (the borrower) via an approved intermediary.
- The Borrower is obliged to return them either on demand or at the end of an agreed term and also has an option to early return. Lender may recall securities at any time within normal market settlement cycle. SLB is a major and growing activity which provides significant benefits for issuers, investors and traders alike.
- SLB helps in improving market liquidity, more efficient settlement, tighter dealer prices and perhaps a reduction in the cost of capital

WHY PARTICIPATE IN SECURITIES LENDING & BORROWING?

- • Lender's Motivation
- • It provides lender incremental return on an idle portfolio.
- • Borrower's Motivation
- • To cover a short position: avoidance of settlement failure.
- • Hedging of futures & options positions.
- • Borrow and lend to reap benefits of the market sentiment.

SETTLEMENT SYSTEM

- Settlement is the process of netting of transactions and actual delivery/receipt of securities and transfer deeds

against receipts/payment of agreed amount. It is necessary to make a settlement to know the net effect of a series

of transactions during a given period.

- Settlement date is the date specified for delivery of securities between securities firms. For administrative

convenience, a stock exchange divides the year into a number of settlement periods so as to enable members to

settle their trades. All transactions executed during the settlement period are settled at the end of the settlement

period.

- Settlement risk or principal risk is the risk that the seller of a security or funds delivers its obligation but does not

receive payment or that the buyer of a security or funds makes payment but does not receive delivery.

- In this event, the full principal value of the securities or funds transferred is at risk.

Evolving Role of Equity Market

DEVELOPMENTS IN INDIAN CAPITAL MARKET

- Economic Liberalization due to Indian Capital Market:
- The economic liberalization has led to more deregulation, liberalization and privatization of some of the public sector undertakings in India. This has resulted in the shares of some of the public sector undertakings being made available to the public. The Industrial policy adopted by the government earlier did not allow investment in core sector by either individuals or private sector. But, with the privatization of some of the public sector undertakings, the shares are now available to the public for contribution. Example: Steel Authority of India (SAIL). The Navarathna companies, consisting of major public sector undertakings such as ONGC, BHEL, Oil India Ltd, Gas Authority etc., are some of the companies which are yet to be privatized. Recently, the shares of VSNL were bought by TATAs.

PROMOTING MORE PRIVATE SECTOR BANKS

- Opening of more private sector banks has resulted in the public contributing to the shares of these banks in Indian capital Market. Recently, the government has announced 74% equity participation by foreigners in private sector banks in India. This has not only promoted new banks but also paved the way for the merger of existing banks with other banks. Example: The merger of Bank of Madura with ICICI Bank.

REGULATION OF NRI INVESTMENTS:

- The Amendment of Foreign Exchange Regulation Act (FERA) into Foreign

Exchange Management Act (FEMA) has given more encouragement to non resident investors. The percentage of NRI investment in Indian companies has been increased from 5% to 24%. In the year 1991, India faced an acute shortage of foreign exchange and the then finance minister adopted certain methods to improve the foreign exchange reserves. He allowed investment by any individual NRI in any Indian company from the then existing 5% of paid-up capital to 24%. This had resulted in more inflow of foreign funds into India.

DIRECT FOREIGN INVESTMENT:

- The Foreign Investment Promotion Board, consisting of the Secretaries of industries, finance and foreign affairs, have allowed more direct foreign investment in core sector, especially in power sector.

FERA COMPANIES:

- Under the Foreign Exchange Regulation Act, a FERA company is one which has 40% equity participation by foreigners. This limit has been removed and now even foreign companies are allowed to have 51% equity participation. For example, Colgate Polmolive has increased its foreign equity participation from 40 to 51%. As a result, we are able to attract more foreign capital into Indian capital market. The FERA Act has since been amended and is now known as Foreign Exchange Management Act (FEMA).

ONLINE TRADING IN INDIAN CAPITAL MARKET

- Some of the leading stock markets in India have introduced computer system for their trading activities. The brokers can get hooked-up and do their trading on Online basis. The computer terminals will enable the public and the brokers to know the price prevailing in the market at any time. This will prevent speculation

activities.

TRANSPARENCY THROUGH ONLINE TRADING:

- The online trading through computer has brought in transparency to the transactions in the market. People are able to know prices prevailing in the market at any time and as such the brokers cannot deprive their clients of their profits. The manipulation in the opening and closing prices of shares by the brokers in the market are no longer possible.

NATIONAL STOCK EXCHANGE:

- A new stock market called National Stock Exchange has been created which has a large number of companies listed. It is a big competitor to the Bombay Stock Exchange and it is able to even influence the Bombay Stock Exchange. The National Stock Exchange deals in shares of companies throughout India and the prices prevailing in the market is a benchmark for stock prices. The creation of National Stock Exchange has not only widened the market, but has also subdued the Bombay Stock Exchange. It has paved the way for all the leading companies' equities being traded through a single market. Thus, it enables the public to know the true picture of the companies and their real strength.

DEMATING OF SHARES IN INDIAN CAPITAL MARKET:

- The introduction of demating has resulted in improving transactions further. Demating is a system under which physical delivery of shares is no more adopted. It is called "scripless trade". The shares of individual investors are held by stock holding company and a pass book is given to individual investors. Any sale or purchase of shares will result in entries made in the pass book. The companies

concerned are also informed for making due alterations in the share register.

SECURITIES AND EXCHANGE BOARD OF INDIA:

- The creation of Securities and Exchange Board of India (SEBI) is an important development in Indian capital market of India. SEBI has not only replaced the Controller of Capital issues, but has brought in uniformity in the transactions in all stock exchanges.

RENEWAL OF REGISTRATION:

- All the brokers and sub brokers have to register afresh with SEBI and any complaints against them will be inquired and if found guilty, punishment is given.

OVER THE COUNTER EXCHANGE OF INDIA (OTCEI):

- For the purpose of newly promoted companies, another stock exchange with lesser degree of conditions has been promoted and it is called Over the Counter Exchange of India (OTCEI). It may not be possible for all the newly companies to list their shares with the existing stock exchanges. The share capital of these companies will be low and hence there should be an arrangement for listing such companies' shares. The creation of Over-the-Counter Exchange of India (OTCEI) is helpful to these newly promoted companies.

EDUCATING PUBLIC:

- Press and media have contributed a lot in popularizing the Indian capital market and they are highlighting the prices of securities every day. The mutual funds and

merchant banks have been asked to set apart a portion of their funds towards educating the public on the developments in the Indian capital market.

GOVERNMENT SECURITIES MARKET:

- After the stock scam, the Central Government has de-linked Government securities from trading along with company securities. In other words, there will be separate market for Government securities and they will not be dealt along with company securities in the stock market. The measure was taken by Dr. Manmohan Singh when he was the Finance Minister.

PENALTY FOR INSIDER TRADING IN INDIAN CAPITAL MARKET

- In 2002, SEBI Act was amended to make insider trading punishable as a serious offense. The penalty rate has been enhanced to Rs. 1 lakh per day and the maximum penalty can go up to Rs. 25 crores.

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BADLA TRANSACTIONS IN INDIAN CAPITAL MARKET:

- Badla is a transfer of a contract from one period to another, where, either the buyer or the seller is unable to execute the contract for which purpose, the defaulting parties will pay Badla charges (which are decided by the Stock exchange). At present, SEBI has banned Badla transactions.

PERIOD OF SETTLEMENT IN INDIAN CAPITAL MARKET:

- After removing the Badla, SEBI has introduced T+2..... – system for settling transactions in Indian capital market. Accordingly, all transactions entered in the capital market, should be completed within 2 days excluding the date of trading

MERCHANT BANKER:

- Merchant bankers have been permitted to take part in the stock market. operations and their functions are also regulated by SEBI. They not only help companies in capital budgeting but also guide the foreign investors in the purchase of securities. The merchant bankers, through the financial markets, help some of the Indian companies to obtain fresh capital. They also go in for syndication of loans and help the newly started companies in the issue of shares.

NON-BANKING FINANCIAL COMPANIES:

- Non-Banking Financial Companies:
- The role of non-financial companies has also been controlled. RBI has introduced new conditions, restricting their activities. New norms with regard to capital of non-banking financial companies have been introduced. For chit funds, a separate Act has been passed and it restricts the maximum bidding to 40%

LINK BETWEEN PRIMARY AND SECONDARY MARKET

- The primary and secondary market defines how a security is sold. On the primary market, a security is sold for the first time. This means that the seller is the original issuer of the security being sold. On the secondary market, the security is sold for the second or greater time. In most cases, this means that the two parties making the transaction have no direct connection to the original issuer of the

security. While the primary and secondary market makes up the majority of the capital market.

- The securities market has two segments which are interdependent upon each other. The primary market aims to raise capital by issuing securities and secondary market opens gateway to trade such securities and bring flexibility. Primary markets help in creating financial assets and secondary market make it saleable.

PRIMARY MARKET AND ITS ROLE

- Capital could be regarded as one of the important requirements for production. Capital is formed by means of investments. A

promoter or founder might not have adequate financial resources to fulfil the requirements of a business. Primary market which

is also called the new issue market helps in raising of public before it is made available in the secondary market for liquidity. A

company could raise capital for the first time by going public. This process is regarded as the IPO or Initial Public Offering. A

primary market carries out various roles.

- Some important aspects of primary market are:

- One of the major functions of primary market is to offer new issues. This indicates that the securities

issued in primary market are not traded before in any of the stock exchanges.

- Underwriters play an especially important role in the primary market. They are the assurers who assures

to buy shares that is not sold in the Initial Public Offering. These underwriters play a role to sell the

unsold shares initially to the investors within a certain period.

- Primary market allows flow of investors from new sources to raise the capital of company. The public is

invited and the details of the company along with its underwriters is made by issuing a prospectus.

SECONDARY MARKET AND ITS ROLE

- Secondary market could be referred as follow up of the public offering made in the primary market. Securities that are already issued are traded between investors in the secondary market.

However, secondary market includes even those securities that were not issued in the primary market. secondary market is known as the aftermarket in which previously issued stocks, bonds,

futures, and options are traded. Secondary market helps in determining the real time value of securities. This determination is made based on the demand and supply. There are various types

of secondary market like over the counter market and exchange traded market

- Some of the major functions of secondary market are:

- Liquidity of securities
- Discovery of price
- Informational signaling

- The primary/new issue market cannot function without the secondary market. The secondary market or the stock market that provides liquidity for the issued securities. The issued securities are traded in the secondary market offering liquidity to the stocks at a fair price.

- The new issue market provides a direct link between the prospective investors and the company. By providing liquidity and safety, the stock markets encourage the public to subscribe to the new issues. The marketability and the capital appreciation provided in the stock market are the major factors that attract the investing public towards the stock market. Thus, it provides an indirect link between the savers and the company.

- The stock exchanges through their listing requirements, exercise control over the primary market. The company seeking for listing on the respective stock

exchange has to comply with all the rules and regulations given by the stock exchange.

- Though the primary and secondary markets are complementary to each other, their functions and the organizational set up are different from each other. The health of the primary market depends on the secondary market and vice versa.

WAYS OF ATTRACTING MORE INVESTORS

Have audited, or at least reviewed, financials for the prior three years. Validation of your numbers and processes from a quality accounting firm greatly will help your sale and valuation. Most important, the buyer and potential lenders will have confidence in your numbers and company. This will save time, cost and potentially increase available leverage. Three years of review or audit isn't required, but the more years the better.

- Be sure your stated objectives for the sale match your personal objectives. In the fundraising process, you are going to be telling your story again and again. Make sure that the story you tell prospective investors why you want to expand your business, what your eventual exit strategy is, and what you want to do after that. If not, potential deal-killing issues can arise further down the closing path
- Have in place qualified leadership. Company leadership is one of the greatest concerns of most buyers. If you are not going to be there, a buyer needs to have confidence in those who are. The ideal scenario is if your company can grow and flourish without you there.
- Have an actionable strategic plan that shows growth. Without question, the more potential an investor believes your company has, the higher the valuation you will receive when you raise capital. If you have a believable, actionable strategic plan that shows significant growth, investors will be excited. The important thing to keep in mind is that your plan should be both ambitious and reasonable. Investors will be turned off if you

present them with farfetched numbers or if you fail to acknowledge market realities.

- Hit or exceed your annual budget, particularly prior to and during the fundraising process. This also is about buyer and lender confidence. If, during the sale process your company does not hit the numbers you said it would, they begin to doubt and second guess the entire transaction. If, on the other hand, you beat the numbers, they become afraid of losing the transaction and work harder to close as quickly as possible.
- Don't be your company's best salesperson. A typical weakness of entrepreneurial companies are a lack of sales talent, other than the owner, not to mention the lack of a formal sales strategy. If your company has a sales department that can close deals and increase revenue while you are busy with other things (or on vacation, for that matter) investors will have much more confidence in your plan
- Bring in experienced legal counsel. Lawyers with experience in the field of entrepreneurial dealmaking will help you conduct efficient negotiations. They should know the issues to fight over and those that don't matter. Your existing corporate counsel may not have sufficient experience
- Be patient. Raising outside capital almost always takes longer than the entrepreneur wishes. The typical fundraising process lasts about six months, but can take much longer, particularly if your company is still in the start-up stage and lacks a track record of meeting its goals. Be mentally prepared for a long and winding road paved with rejection. There will be countless economic, legal, and emotional hurdles that you will have to overcome to get the best result for your business

ROLE OF SEBI IN CAPITAL MARKET

- SEBI is regulator to control Indian capital market. Since its establishment in 1992, it is doing hard work for protecting the interests of Indian investors. SEBI gets

education from past cheating with naive investors of India. Now, SEBI is more strict with those who commit frauds in capital market.

The role of security exchange board of India (SEBI) in regulating Indian capital market is very important because government of India can only open or take decision to open new stock exchange in India after getting advice from SEBI.

- If SEBI thinks that it will be against its rules and regulations, SEBI can ban on any stock exchange to trade in shares and stocks.

ROLE OF SEBI IN REGULATING INDIAN CAPITAL MARKET

MORE DEEPLY WITH FOLLOWING POINTS:

- 1. Power to make rules for controlling stock exchange:

SEBI has power to make new rules for controlling stock exchange in India. For example, SEBI

fixed the time of trading 9 AM and 5 PM in stock market.

- 2. To provide license to dealers and brokers:

SEBI has power to provide license to dealers and brokers of capital market. If SEBI sees that any

financial product is of capital nature, then SEBI can also control to that product and its dealers.

One of main example is ULIPs case. SEBI said, " It is just like mutual funds and all banks and

financial and insurance companies who want to issue it, must take permission from SEBI."

- 3. To Stop fraud in Capital Market:

SEBI has many powers for stopping fraud in capital market.

- It can ban on the trading of those brokers who are involved in fraudulent and unfair trade practices relating to stock market.

- It can impose the penalties on capital market intermediaries if they involve in insider trading.

- 4. To Control the Merge, Acquisition and Takeover the companies:

- Many big companies in India want to create monopoly in capital market. So, these companies buy all other companies or deal of merging. SEBI sees whether this merge or acquisition is for development of business or to harm capital market.

- 5. To audit the performance of stock market:

SEBI uses his powers to audit the performance of different Indian stock exchange for bringing transparency in the working of stock exchanges.

- 6. To make new rules on carry - forward transactions:

- Share trading transactions carry forward cannot exceed 25% of broker's total transactions.

- 90-day limit for carry forward.

- 7. To create relationship with ICAI:

ICAI is the authority for making new auditors of companies. SEBI creates good relationship with ICAI for bringing more transparency in the auditing work of company accounts because audited financial statements are mirror to see the real face of company and after this investor can decide to invest or not to invest. Moreover, investors of India can easily trust on audited financial reports. After Satyam Scam, SEBI is investigating with ICAI, whether CAs are doing their duty by ethical way or not.

- 8. To Require report of Portfolio Management Activities:

SEBI has also power to require report of portfolio management to check the

capital market performance. Recently, SEBI sent the letter to all Registered Portfolio Managers of India for demanding report.

- 9. To educate the investors:

Time to time, SEBI arranges scheduled workshops to educate the investors.

Primary market refers to the raising of equity or debt capital by investments made from investors. In primary market the

investors get an opportunity to buy securities directly from the issuer. Primary market is called the new issue market because the

securities are issued for the first time. Primary market allows the issuer to expand its business by gathering long-term capital

from diverse investors.

An issuer in the primary market requires various intermediaries to carry out the process of raising funds from investors.

Law relating to issue of Shares

EMPLOYEE STOCK OPTION PLANS

- Employee Stock Option Plans are the plans in which employees get the right to purchase a number of shares

(decided by the employer) in lieu of Salary in the company at a discounted price (less than the market price). The

option provided under this scheme confers a right but not an obligation on the employee.

- Employees have to wait for a certain time period – known as vesting period – before they can exercise the right to

purchase those specified number of shares. Upon vesting of options, employees can exercise the options to get

shares by paying the pre-determined exercise price.

- ESOPs are generally awarded for performance or tenure of the employee with the company. Thus, it serves a

two-fold purpose for both the company and the employees.

- 1. It acts as a tool of motivation for the employees that once they own a stock, they feel responsible for performance

of the company, as it determines the value of the stocks of the company.

- 2. It helps the employer to retain the company and assure a good level of performance in the work.

STEP BY STEP PROCESS FOR ISSUE OF ESOP

- 1. Preparation of list of eligible employees for ESOP

- This is the first step and basic step required for ESOP scheme. Employees should be carefully selected for participation in ESOP scheme after considering his/her experience, roles and responsibility etc.

2. PREPARATION OF ESOP POLICY

- It is the most important step for Companies. Following are essential things that must be kept in mind while drafting ESOP policy Quantum of ESOP pool;

- Employees Selection and evaluation criteria for participating in the scheme;
- Rights of option holders;
- Rights of shareholders
- Exit mechanism;
- Tax liabilities.

3. BOARD APPROVAL

• After preparation of list of eligible employees, quantum of options, drafting of ESOP scheme, next step is to convene a Board Meeting for final board approval. Board has to approve list of employees participating in the scheme, draft ESOP scheme, notice of general meeting for approval of shareholders.

• 4. General Meeting

• General Meeting of members of the company will have to convene for them approval of ESOP scheme by Special Resolution. However, Only Ordinary Resolution is required for issue ESOP by Private Limited Company.

• 5. Filing of Form MGT-14

• E-form MGT-14 must be filled by all the companies (Except Private Limited Company) attaching Special Resolution for approval of Scheme, Explanatory Statement, Notice of GM, and approved ESOP policy.

• 6. Preparation & Dispatch of Grant Letter

• After approval of shareholders, Company needs to send Grant Letter to all the eligible shareholders to participate in the scheme mentioning their entitlement, vesting schedule, date of vesting, last date up to which exercise can be made, exercise price, manner of exercise of options and other terms and conditions.

• 7. Vesting of ESOPs

• There must be minimum 1 year time gap in between granting of option and vesting of option. For e.g.: If you grant the option on 01st April, 2019, it can't be exercised before

01st April, 2020.

- 8. Exercise of ESOPs
 - After completion of vesting period, employees can apply for shares or further wait up to the last date on which exercise can be made or not apply for the shares.
 - ESOP grants only right and not obligation to employees for purchase of shares.
- 9. Allotment of Shares
 - If shareholders apply for shares, companies need to allot the shares and file e-form PAS-3 for allotment of shares by attaching Special or Ordinary Resolution for approval of ESOP, Resolution for allotment of shares, list of allottees etc.
- 10. Issue Share Certificate & Payment of Stamp Duty
 - Company needs to issue share certificate to the shareholders within 30 days after allotment. Companies need to pay stamp duty on issue of shares according to the stamp rates prevailing in the state.

WHAT IS AN ESPP OR EMPLOYEE STOCK PURCHASE PLAN?

- An ESPP is a company-run program where the participating employees can buy the company stock at a discounted price. Employees donate to the plan through their payroll deductions that build-up between the purchase date and the offering date. On the day of the purchase, the company utilizes the accumulated funds to buy the stock in the company for the participating employees.
- The discount rate on the shares of the ESPP is completely dependent on the plan. But the discount can be as low as 15% from the market price

ELIGIBILITY

- ESPPs don't permit shareholders who already own more than 5% of the company stock to participate in the plan. In addition to this, other restrictions are usually in place to disallow employees who haven't been employed with the company for a specified

duration, usually less than one year.

PROS OF AN ESPP

- There are a lot of reasons why you should incorporate an ESPP plan in your business. Below are the reasons

why:

- Huge gains for employees: Employees can easily enjoy huge gains with this program. For instance, let us

assume that the stock of the company costs \$30 now when the price is set for the ESPP plan. For the next 6

months, the employees save money to buy the shares when they are allowed to purchase them. But at this time,

the stock price reaches \$60. Of course, you will still pay \$30 for the stock. And in case you sell the stock

instantly, you will end up doubling the amount that you earned from the saving period. This means that the

employee will gain a lot out of the ESPP program which is why it is considered as a “guaranteed bonus”.

- Creates an alignment of interests: A lot of employees do not focus on the mission of the company. All they

care about is that their job is done well and they earn a pay check at the end of the month. By offering an ESPP,

the company can shift this vision of the employee towards the long-term future of the company. So, the ESPP

changes the perspective of the employee and aligns their interests with the company’s mission.

PROS OF AN ESPP

- Offers a vesting period: Even though there are many ESPP benefits in place, vesting periods are needed to get the complete value of the stock purchase. When a stock provides a good value

bump to the income of a worker, you are more likely to retain your top workers to keep pushing

forward on growth. During this time, you will also be able to teach a specific level of pride within

the workforce that encourages higher levels of productivity.

- Reduces turnover rates: With a perfect ESPP in place, the rates of turnover and churn in the standard employee population will often go down. This is since the workers begin to see their job

as a long-term investment and not a short-term gain through paychecks. Additionally, there are also higher levels of commitment and loyalty from within each team as the employees would?

be passionate about what they do.

CONS OF AN ESPP

- Again, just like there are good points about something, there are some drawbacks to it as well. With this

said, here are the cons of an ESPP program:

- No guarantee that the employees will come out ahead: A lot of the ESPP programs offer a discount

on the purchase price of the stock or stock options price for the employee. But if the ESPP is set up like a

traditional stock option, then there is a chance that the employees might not benefit from the program.

This plan would not excite your employees and would fail to incentivize them.

- Might need a holding period: If your company's ESPP has a holding period before the employee can

sell the stock that they purchase, it can turn out to be negative. This is because the total gains that they

could get would be limited and they would rather stay away from the plan. So, ensure that this is not the

case when preparing your summary plan description (SPD).

CONS OF AN ESPP

- Tax implications to consider: If an employee sells off their ESPP stock purchase instantly after

they get it for a profit, they will need to pay the standard income tax on the discount they were

offered. And the income tax rate is 15% of the amount, which is a lot. And that is not all. After

this, the employee would also have to pay the short-term capital gains on the profits they get from

the sale.

- Regulatory issues to consider: Just like every other stock option plan, an ESPP program will have to be compliant with the various rules to run smoothly. This means that you will need an officer who would oversee the program and make sure all the security and tax laws are being followed. If not considered and followed, the company could attract penalties and other issues.

And taking care of it would cost you a lot on an ongoing basis.

PROCEDURE FOR ISSUE OF VARIOUS TYPES OF SHARES AND DEBENTURES

- INTRODUCTION

- Debenture includes debenture stock, bonds or any other instrument of a company that is evidence of a debt, whether it has or not constituted a charge on the assets. [Section 2(30)]

MANDATORY REQUIREMENTS

1. Debentures cannot be issued with voting rights.

2. A Company cannot issue debentures to more than 500 people without appointing a debenture

trustee, whose duty would be to protect the interest of Debenture Holders and redress them grievances.

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

4. If there is any default in repayment of amount in the event of maturity or default in payment of

the interest thereon then the Tribunal will be approached by the Debenture Trustee to take appropriate measures

FOLLOWING PROCEDURE IS TO BE
FOLLOWED

Intimation to the Stock Exchange [Regulation 29 of the SEBI Regulations, 2015]

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

CONVENE A MEETING OF BOARD OF
DIRECTORS [AS PER SECTION 173 & SS-1]

- Issue Notice of Board Meeting to all the Directors of Company at their addresses registered with the Company, at least 7 days before the date of Board Meeting. A shorter notice can be issued in case of urgent business.
- Attach Agenda, Notes to Agenda and Draft Resolution with the Notice.
- Hold a meeting of Board of Directors of the Company and pass the necessary Board Resolution
- to consider and approve issue of debentures through private placement.
- to approve Private Placement, Offer Letter.
- to identify the group of persons to whom Private Placement shall be made.
- to fix day, date, time and venue for holding General Meeting of the Company.
- to approve the draft notice of General Meeting along with explanatory statement annexed to the notice as per requirement of the Section 102 of the Companies Act, 2013.

- to authorize the Director or Company Secretary to sign and issue notice of the General Meeting and to do such acts,

deeds and things as may be necessary to give effect to the Board's decision.

- Listed Company shall submit the outcome of Board Meeting within the timelines specified therein from the

conclusion of the Board Meeting and post the same on the website of the Company within 2 working

days. [Regulation 30 & 46(3) of the SEBI (LODR) Regulations, 2015]

- Prepare and Circulate Draft Minutes within 15 days from the conclusion of the Board Meeting, by Hand/Speed

Post/Registered Post/Courier/E-mail to all the Directors for their comments

File Form MGT-14 with ROC

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

Obtain Shareholders' Approval

1. By Convening a General Meeting, OR
2. By Passing a Resolution by Postal Ballot.

Open Separate Bank Account

Company shall open a separate Bank Account in a Scheduled Bank for keeping the money received on the

application.

Preparation and Filing of Private Placement Offer Letter

1. Company shall record the names of the persons to whom the debenture through Private Placement shall be

offered.

2. Company shall make a Private Placement Offer Letter in Form PAS-4 and shall send these offer letters either in

writing or in electronic mode within 30 days of recording of names of such person with an application form

serially numbered to the person to whom it is made.

3. Company shall maintain a complete record of persons to whom the private placement offer letter is sent in

Form PAS-5.

Receive the Amount of Subscription

1. Company shall receive the amount of subscription through cheque or demand draft or other banking channels from the Bank Account of the person subscribing to debentures except in case of issue of debentures for consideration other than cash.

2. Company shall keep the record of the Bank account from where such payments for subscriptions have been received.

Make necessary Entries in Registers

Private Company shall make necessary entries in the Register of debenture holders in Form MGT-2

within 7 days of the Board Meeting in which the allotment of Debentures was approved.

File Return of Allotment with ROC

Company shall file return of allotment within 15 days from the date of allotment in Form PAS-3 with the

Registrar of Companies (ROC) along with following attachments

1. List of allottees, separate list for each allotment is mandatory

2. Copy of Board or Shareholders' resolution approving allotment of debentures is mandatory in all cases

3. Complete record of private placement offers and acceptances in Form PAS-5 is mandatory in case of private

placement

4. Any other information can be provided as an optional attachment(s).

Issue the Relevant Certificates

Private Companies which have not allotted Debentures in demit format shall issue and deliver the

debentures certificates within a period of 6 months from the date of allotment.