MAR GREGORIOS COLLEGE OF ARTS & SCIENCE

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DEPARTMENT OF COMMERCE (CORPORATE SECRETARYSHIP)

SUBJECT NAME: SECURITIES LAWS AND MARKET OPERATIONS

SEMESTER: VI

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CORE PAPER X – SECURITIES LAWS AND MARKET OPERATIONS

UNIT-I

Introduction Salient features of SEBI Act 1992 & Securities Contract Regulation Act - SEBI Guidelines relating to the functioning of the New Issue Market - SEBI Guidelines for Disclosure and Investor Protection

UNIT-II

Stock Market Primary and Secondary Markets; Role and Functions of New Issue Market; Methods of Floatation, Pricing of Issues, Promoters Contribution, Offer Documents, Underwriting of Issues and Allotment of Shares, Appointment and Role of Merchant Bankers, Underwriters, Brokers, Registrars, Lead Managers and Bankers.

UNIT-III

Stock Exchanges Meaning, Functions, Importance and Limitations; Mechanics of Stock Market Trading Different Types of Orders, Screen Based Trading and Internet Based Trading; Settlement Procedure; Types of Brokers; Listing of Securities in Indian Stock Exchanges - classification and listing of securities.

UNIT-IV

Trading Pattern in OTCEI and NSE Meaning, Significance and Functions, Procedure of Listing and Trading on OTC; NSE Functioning and Trading Pattern in NSE-Capital Market Segment; Security Market Indicators - Need and Importance; BSE Sensex, NSE, NIFTY and other Index Numbers.

UNIT-V

Demat Trading& Mutual Funds Meaning and Significance; SEBI Guidelines and other Regulations Relating to Demat Trading; Procedure of Demat Trading; Role of Depositories and Custodial Services. Introduction, definitions, types, risks involved, performance evaluation and SEBI regulations for mutual funds.

UNIT STRUCTURE:
UNIT 1
1.1 Learning outcomes
1.2 Introduction Salient features of SEBI Act 1992
1.3 Securities Contract Regulation Act
1.4 SEBI Guidelines relating to the functioning of the New Issue Market
1.5 **SEBI Guidelines for Disclosure and Investor Protection**

1.1 LEARNING OUTCOMES

- Students will be able to understand the importance of establishment of SEBI
- Students will be able to understand all basic guidelines and procedures for trading.

1.2 SALIENT FEATURES OF SEBI- SECURITY AND EXCHANGE BOARD OF INDIA

SEBI or the Security and Exchange Board of India is a regulatory body controlled by the Government of India to regulate the capital and security market. Before the Security and Exchange Board of India, the Controller of Capital Issues was the regulating body to regulate the market which was controlled by the Capital Issues (Control) Act, 1947.

Majorly, SEBI controls the issuers of securities, the investors and the market intermediaries. The Board draft regulations and statutes under its legislative authority, also pass rulings and orders under its judicial capacity and operate investigations in its executive limits. SEBI works as a barrier to avoid malpractices related to the stock market by establishing a code of conduct and promoting the healthy functioning of the stock exchange. Initially, SEBI didn't have the authority to regulate the stock exchange, but in 1992 the Union Government gave statutory powers to SEBI through the SEBI Act, 1992.

Purpose and Role of SEBI

SEBI helps in creating a healthy environment to facilitate an effective mobilization between the market participants and investors. It helps in locating the resources with the help of the securities market. SEBI establish rules and regulations, policy framework and infrastructure to meet the needs of the market. The financial market majorly comprises of three groups:

The Issuer of Securities

Issuers are the group that works in the corporate department to easily raise funds from the various sources of the market. So, SEBI helps the issuers by providing them a healthy and open environment to work efficiently.

Investors

The investors are the soul of the market as they keep the market alive by providing accurate supplies, correct information, and protection to the people on a daily basis. SEBI helps investors by creating a malpractice free environment to attract and protect the money of the people who invested in the market.

Financial Intermediaries

The intermediaries are the people who act as middlemen between the issuers and the investors. SEBI helps in creating a competitive professional market which gives a better service to the issuers and the investors. They also provide efficient infrastructure and secured financial transactions.

Features of SEBI

SEBI is an organization that is responsible for maintaining an environment that is free from malpractices to restore the confidence of the general public who invest their hard-earned money in the market. SEBI controls the bylaws of every stock exchange in the country. SEBI keeps an eye on all the books of accounts related to the stock exchange and financial intermediaries to check their irregularities. The features of the Security and Exchange Board of India are given below:

- **Quasi-Judicial**

SEBI is allowed to conduct hearings and can pass judgments on unethical cases and fraudulent trade practices. This feature of SEBI helps to protect transparency, accountability, reliability, and fairness in the capital market.

- **Quasi-Legislative**

SEBI is allowed to draft legislatures with respect to the capital market. SEBI drafts rules and regulations to protect the interests of the investors. For eg: SEBI LODR or Listing Obligation and Disclosure Requirements. This helps in consolidating and streamlining the provisions of existing listing agreements for several segments of the financial market like equity shares. This helps in protecting the market from malpractices and fraudulent trading activities happening at the bay.

- **Quasi-Executive**

SEBI covers the implementation of the legislation. They are allowed to file a complaint against any person who violates their rules and regulations. They also have the power to inspect all the books and records to check for wrongdoings.

SEBI Act

The Parliament established the Securities and Exchange Board of India Act,1992 or SEBI Act, 1992 to regulate and develop the securities market in India. It was further amended to meet the changes in the developing requirements of the securities market.

1.2 FEATURES AND REGULATIONS OF THE ACT

SEBI is an organization that is responsible for maintaining an environment that is free from malpractices to restore the confidence of the general public who invest their hard-earned money in the market. SEBI controls the bylaws of every stock exchange in the country. SEBI keeps an eye on all the books of accounts related to the stock exchange and financial intermediaries to check their irregularities. SEBI Act defines and gives powers to the body.

The SEBI Act is divided into seven chapters that provide the rules and regulations associated with the capital market.

- The First Chapter is an introductory or preliminary chapter of the Act which provides the title, extent, and definitions of the terms used in the Act.
- The Second Chapter is the establishment of the Securities and Exchange Board of India. This chapter deals with management, employees, meetings, and the office of the board. This provides the necessary details of the board established by this Act.
- The Third Chapter is the transfer of assets, liabilities, etc. of the existing Security and Exchange Board to the Board, which means it declares the provisions to be used to transfer the assets in the case of the formation of a new board.
- The Fourth Chapter is the powers and functions of the Board. This chapter helps in mentioning the powers and functions of the board which are given by the Act. The Board is bound to follow the instructions given by the act and is not allowed to exploit their powers.
- The Fifth Chapter is the Registration Certificate. It deals with the documentation involved in the registration of the stockbrokers, sub-brokers, and share transfer agents, etc.
- The Sixth Chapter is finance, accounts, and audits. This chapter controls all the grants given by the Central Government, funds and accounts, to ensure the productivity of the board as well as the capital market.
- The Seventh Chapter miscellaneous, which discusses other topics that are relevant to the board and the market. To help the board from avoiding mistakes.

The laws and regulations of the Security and Exchange Board of India are very important and must be followed seriously by the people who are entitled or registered with the stock exchange and capital market of India. The SEBI Act, 1992 is the supreme power of the securities market of India and has the authority to make laws and regulations. And these rules and regulations are applied to all the listed companies, their board of directors, key managerial personnel of such companies, investors, and all the other companies who are associated with the security market sector.

The most valuable regulations promoted by SEBI are:

- **Regulations on the Issue of Capital and Disclosure Requirements, 2009**

These regulations helped with the issues related to capital and disclosure by improving the trading in securities of the listed companies and investors in India.

- **Regulations on Substantial Acquisition of Shares and Takeovers, 2011**

These regulations of SEBI were established to solve difficulties related to the legal and fair acquisition of shares and takeovers.

- **Regulations on Prohibition of Insider Training, 2015**

These regulations introduced new provisions for prohibiting the insider training of securities and tries to protect the laws for lawful and fair trading in India.

- **The Equity Listing Agreement**

These provisions were a reminder of the clauses which mainly dealt with the mandatory compliances to be made between the stock exchange of India and the listed companies.

Scope of Act

The Preamble of the SEBI Act, 1992 provides that SEBI came into force to cover two objectives:

- To protect the interests of investors in Securities.
- To promote the development and regulations of the securities market.

All the provisions and regulations are made to achieve their goal of improving the market and to reach their goal. SEBI acts like a mini-state as it works includes executive, judiciary and legislature. Section 11 of the SEBI Act allows the board to work on its objective.

SEBI controls:

- The regulations of the stock exchange and capital market.
- Prohibition of fraudulent and unfair trade.
- Improving education and training of intermediaries of the securities market.
- Promoting investors and registering intermediaries.
- Regulating substantial acquisition of shares and takeovers of companies.
- Calling for information and records.
- Conducting inquiries of audits and stock exchanges.

SEBI is India's capital market regulator and is trying to benefit the investors by:

- Increasing the trading volumes
- Syncing with the Global Markets
- Hedging

SEBI helped the market participants by consolidating their settlement functions at a single clearing meeting and by reducing the effective trading cost for investors. The board improved the market by allowing the contributions of the foreign participants through certain background checks before entering the Indian Market.

1.2 SEBI GUIDELINES FOR IPO- INITIAL PUBLIC OFFERING

An issue making public offer issue shall adhere to the conditions of Chapter III of SEBI (ICDR) Regulations as on the date of filing a draft offer document with the Board (SEBI) and also at the time of registering the offer document with the Registrar of Companies.

Necessary conditions for Making an initial Public Offer (IPO) issue:

1. An issuer making an initial public offer must fulfill that:

    - It has net tangible assets of at least three crore rupees in each of the preceding three full years (each year of twelve months), of which not more than fifty percent. are held in monetary assets:
    - it has a past record of distributable profits for at least three out of the immediately preceding five years as per section 205 of the Companies Act, 1956. Thus it shall be a profit-making company. While calculating the distributable profits extraordinary items shall be excluded in such calculation;
    - it must have a net worth of at least one crore rupees in each of the preceding three full years (each year of twelve months);
    - the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size must not exceed five times its pre-issue net worth calculated as per the audited balance sheet of the preceding financial year;
    - if it has changed its name during the last one year, at least fifty percent of the revenue generated for the preceding one full year has been earned by it from the activity mentioned by the new name.

2. An issuer not fulfilling any of the conditions prescribed in sub-regulation (1) may make an initial public offer if:

- The issue is made through the book building process and the issuer promises to allow at least fifty percent. of the net offer to the public, qualified institutional buyers and to refund full subscription amount if it fails to make an allotment to the qualified institutional buyers, or
- At least fifteen percent. Of the cost of the project is contributed by scheduled commercial banks or public financial institutions, out of which at least ten percent. Shall come from the appraisers and the issuer guarantees to allow at least ten percent. of the net offer to the public, to qualified institutional buyers and to refund full subscription amount if it fails to make the allotment to the qualified institutional buyers;
- the minimum amount post-issue face value capital of the issuer is ten crore rupees; or

- the issuer commits to furnish market-making for at least two years from the date of listing of the particular securities, subject to the following:

a) the market makers offer to buy and sell quotes for at least of three hundred specified securities and confirm that the bid-ask spread for their quotes does not, at any point of time, exceed ten percent.;
b) The inventory of the market makers, as on the date of allotment of the specified securities, shall not be less than five percent. of the proposed issue.

3. An issuer may make an initial public offer(IPO) of convertible debt instruments even though he has not undertaken a prior public issue of its equity shares and further listing thereof.
4. An issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is below one thousand.
5. No issuer shall make an initial public offer(IPO) if [as on the date of registering the prospectus with the Registrar of Companiesi) there are any outstanding convertible securities or ii) any other right entitling any person any option to receive equity shares after the initial public offer:
Provided that the norms of this sub-regulation shall not apply to:

- a public issue brought out during the prevalence of convertible debt instruments issued through an earlier initial public offer if the conversion price of such convertible debt instruments was fixed and mentioned in the prospectus of the earlier issue of convertible debt instruments;
- Outstanding options permitted to employees under an employee stock option scheme (ESOS) formulated in consonance with the relevant Guidance Note or Accounting Standards, if any, issued by the Institute of Chartered Accountants of India (ICAI) in this matter.

6. Subject to provisions of the Companies Act, 1956, equity shares may be offered for sale to the public if such equity shares have been held by the sellers for a period of at least one year before the filing of draft offer document with the Board under the provisions of sub-regulation (1) of regulation 6:

Provided that in the case where the equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities and also depository receipts are being offered for sale, the holding period of such convertible securities and that of resultant equity shares together shall be considered for calculation of one-year period prescribed in this sub-regulation:

Provided further that the requirement of holding equity shares for a period of one year will not be applicable:

1. in case of an offer for sale of specified government company securities or statutory authority or corporation or any special purpose vehicle formed and controlled by any one or more of them, which is engaged in infrastructure sector activities;
2. if the specified securities offered for sale were acquired under any scheme approved by a High Court under sections 391-394 of the Companies Act, 1956, in place of business and invested capital which is existing for a period of more than one year prior to such approval.

7. No issuer shall make an initial public offer without obtaining grading for the initial public offer from at least one credit rating agency registered with the Board. This has to be as on the date of registering prospectus or red herring prospectus with the Registrar of Companies.

1.3 SEBI GUIDELINES FOR DISCLOSURE AND INVESTOR PROTECTION

- SEBI has been encouraging investor-education. For this purpose, certain investors' associations have been registered.
- Companies raising public deposits as well as huge capital must undergo credit rating. Credit rating by an authorized authority gives a fair view about the financial strength of the organization. For this purpose, there are four credit rating agencies. They are: CRISIL, ICRA, CARE andDuff and Phelps Credit Rating India Pvt. Ltd.
- SEBI has taken the responsibility of disclosing fair and adequate information for investors for the purpose of investment decisions.
- For the benefit of the investors, company has to disclose its capacity utilization, adverse events and material changes of key personnel.
- Disclosure on market prices for listed company.
- Arrangement for disclosing investors grievances and redressal system.
- Compulsory disclosure in the prospectus.
- Contribution by promoters whose name figure in the prospectus.
- In case of over subscription of any company issue, SEBI representatives will be present there to look into the allotment process.
- Setting up of investors grievances cell for handling complaints of investors.
- SEBI has right to cancel registration of any underwriter who fails to furnish business details to SEBI.
- SEBI has made it mandatory for Merchant bankers to attach diligence certificate with the prospectus for extending their accountability to the investors. The diligence certificate gives a detailed position of the issue of shares. Only by such a certificate, the investor can file a case of incorrect statement in the prospectus on erring companies.
- There is an advertisement code by SEBI which has to be followed by companies or investors.

- To avoid any malpractice in allotment process, SEBI has appointed its representatives to look into allotment process which boosts the confidence of individual investors.
- Underwriters, registrar to issue and share transfer agent and portfolio managers have been brought under SEBI for the first time.
- Even the mutual funds have been brought under SEBI and they have to disclose NPV (Net present value) of units every day which benefits investors.
- For the benefit of the individual investors, a new scheme called stock invest account has been introduced in banks. From this stock invest account, the new issue of shares will be applied. In that, the investor will intimate the stock invest account to the company issuing the shares.
- In case of allotment, the company will inform the banker as per SEBI guidelines, and funds will be released from the stock invest account to the bank.

UNIT 2

Unit Structure:

2.1. Learning Outcomes

2.2Stock Market Primary and Secondary Markets

2.3. Role and Functions of New Issue Market

2.4. Methods of Floatation

2.5. Pricing of Issues

2.6. Underwriting of Issues and Allotment of Shares

2.7. Third parties involved in issues.

2.1 LEARNING OUTCOMES

- Helps to link between corporate accounting.
- Students will see how the aspects of corporate accounting will be actualised here using the different methods and technology.

2.2 STOCK MARKET PRIMARY AND SECONDARY MARKETS

Definition: It is a place where shares of pubic listed companies are traded. The primary market is where companies float shares to the general public in an initial public offering (IPO) to raise capital.

Description: Once new securities have been sold in the primary market, they are traded in the secondary market—where one investor buys shares from another investor at the prevailing market price or at whatever price both the buyer and seller agree upon. The secondary market or the stock exchanges are regulated by the regulatory authority. In India, the secondary and primary markets are governed by the Security and Exchange Board of India (SEBI).

A stock exchange facilitates stock brokers to trade company stocks and other securities. A stock may be bought or sold only if it is listed on an exchange. Thus, it is the meeting place of the stock buyers and sellers. India's premier stock exchanges are the Bombay Stock Exchange and the National Stock Exchange.

Primary Market

In a **primary market**, securities are created for the first time for investors to purchase. New securities are issued in this market through a stock exchange, enabling the government as well as companies to raise capital.

For a transaction taking place in this market, there are three entities involved. It would include a company, investors, and an underwriter. A company issues security in a primary market as an initial public offering (IPO), and the sale price of such new issue is determined by a concerned underwriter, which may or may not be a financial institution.

An underwriter also facilitates and monitors the new issue offering. Investors purchase the newly issued securities in the primary market. Such a market is regulated by the Securities and Exchange Board of India (SEBI).

The entity which issues securities may be looking to expand its operations, fund other business targets or increase its physical presence among others. **Primary market example** of securities issued includes notes, bills, government bonds or corporate bonds as well as stocks of companies.

Functions of Primary Market

The functions of such a market are manifold –

- **New issue offer**

The primary market organises offer of a new issue which had not been traded on any other exchange earlier. Due to this reason, it is also called a New Issue Market. Organising new issue offers involves a detailed assessment of project viability, among other factors. The financial arrangements for the purpose include considerations of promoters' equity, liquidity ratio, debt-equity ratio and requirement of foreign exchange.

- **Underwriting services**

Underwriting is an essential aspect while offering a new issue. An underwriter's role in a primary marketplace includes purchasing unsold shares if it cannot manage to sell the required number of shares to the public. A financial institution may act as an underwriter, earning a commission on underwriting.

Investors rely on underwriters for determining whether undertaking the risk would be worth its returns. It may so thus happen that an underwriter ends up buying all the IPO issue, and subsequently selling it to investors.

- **Distribution of new issue**

A new issue is also distributed in a **primary marketing** sphere. Such distribution is initiated with a new prospectus issue. It invites the public at large to buy a new issue and provides detailed information on the company, issue, and involved underwriters.

Secondary Market

A **secondary market** is a platform wherein the shares of companies are traded among investors. It means that investors can freely buy and sell shares without the intervention of the issuing company. In these transactions among investors, the issuing company does not participate in income generation, and share valuation is rather based on its performance in the market. Income in this market is thus generated via the sale of the shares from one investor to another.

Some of the entities that are functional in a secondary market include –

- Retail investors.
- Advisory service providers and brokers comprising commission brokers and security dealers, among others.
- Financial intermediaries including non-banking financial companies, insurance companies, banks and mutual funds.

Different Instruments in the Secondary Market

The instruments traded in a secondary market consist of fixed income instruments, variable income instruments, and hybrid instruments.

- **Fixed income instruments**

Fixed income instruments are primarily debt instruments ensuring a regular form of payment such as interests, and the principal is repaid on maturity. Examples of fixed income securities are – debentures, bonds, and preference shares.

Debentures are unsecured debt instruments, i.e., not secured by collateral. Returns generated from debentures are thus dependent on the issuer’s credibility.

As for bonds, they are essentially a contract between two parties, whereby a government or company issues these financial instruments. As investors buy these bonds, it allows the issuing entity to secure a large amount of funds this way. Investors are paid interests at fixed intervals, and the principal is repaid on maturity.

Individuals owning preference shares in a company receive dividends before payment to equity shareholders. If a company faces bankruptcy, preference shareholders have the right to be paid before other shareholders.

- **Variable income instruments**

Investment in variable income instruments generates an effective rate of return to the investor, and various market factors determine the quantum of such return. These securities expose investors to higher risks as well as higher rewards. Examples of variable income instruments are – equity and derivatives

Equity shares are instruments that allow a company to raise finance. Also, investors holding equity shares have a claim over net profits of a company along with its assets if it goes into liquidation.

As for derivatives, they are a contractual obligation between two different parties involving pay-off for stipulated performance.

- **Hybrid instruments**

Two or more different financial instruments are combined to form hybrid instruments. Convertible debentures serve as an example of hybrid instruments.

Convertible debentures are available as a loan or debt securities which may be converted into equity shares after a predetermined period.

2.3 ROLE AND FUNCTIONS OF NEW ISSUE MARKET

The main function of the New Issue Market is to facilitate the 'transfer of resources' from savers to users. Conceptually, however, the New Issue Market should not be conceived as a platform only for the purpose of raising finance for new capital expenditure.

In fact, the facilities of the market are also utilised for selling existing concerns to the public as going concerns through conversions of existing proprietary enterprises or private companies into public companies.

It, therefore, becomes imperative at this stage to classify new issues. One classification suggested by R.F. Henderson (c.f. The New Issue Market & Finance for Industry, 1951), categorises new issues into those by:

(a) New companies also called 'initial issues' and

(b) Old companies also called 'further issues'.

These bear no relation to the age of the company, but are based on the fact whether the company already has stock exchange listing. This classification is thus concerned only with the flow of 'new money'. Another classification (c.f. Merrett, Howe & New bould "Equity Issues and the London Capital Market" 1967) distinguishes between flow of funds into the market and flow of "new money" hence we have 'new money issues' or issues of capital involving newly created share and ‘no new money issues’ i.e. sale of securities already in existence and sold by their holders.

This is more an “exclusive” classification in that two types of issues are excluded from the category of new issues.

(a) Bonus/capitalisation issues which represent only book keeping entries.

(b) Exchange issues: by which shares in one company are/exchanged for securities of another.

Now, the main function of the New Issue Market, i.e. channelling of investible funds, can be divided, from the operational stand-point, into a triple-service function:

(a) Origination

(b) Underwriting

(c) Distribution

The institutional setup dealing with these can be said to constitute the New Issue Market organisation. Let us elucidate a little on all of these.

(a) Origination :
Origination refers to the work of investigation and analysis and processing of new proposals. This in turn may be:

(i) A preliminary investigation undertaken by the sponsors (specialised agencies) of the issue. This involves a/careful study of the technical, economic, financial and/legal aspects of the issuing companies to ensure that/it warrants the backing of the issue house.

(ii) Services of an advisory nature which go to improve the quality of capital issues. These services include/advice on such aspects of capital issues as: determination of the class of security to be/issued and price of the issue in terms of market conditions; the timing and magnitude of issues; method of flotation; and technique of selling and so on.

The importance of the specialised services provided by the New Issue Market organisation in this respect can hardly be over-emphasized. On the thoroughness of investigation and soundness of judgement of the sponsoring institution depends, to a large extent, the allocative efficiency of the market. The origination, however, thoroughly done, will not by itself guarantee success of an issue. A second specialised service i.e. “Underwriting” is often required.

(b) Underwriting:

The idea of underwriting originated on account of uncertainties prevailing in the capital market as a result of which the success of the issue becomes unpredictable. If the issue remains undersubscribed, the directors cannot proceed to allot the shares, and have to return money to the applicants if the subscription is below a minimum amount fixed under the Companies Act. Consequently, the issue and hence the project will fail.

Underwriting entails an agreement whereby a person/organisation agrees to take a specified number of shares or debentures or a specified amount of stock offered to the public in the event of the public not subscribing to it, in consideration of a commission the underwriting commission.

If the issue is fully subscribed by the public, there is no liability attaching to the underwriters; else they have to come forth to meet the shortfall to the extent of the under- subscription. The underwriters in India may broadly be classified into the following two types:

(i) Institutional Underwriters;

(ii) Non-Institutional Underwriting.

Institutional Underwriting in our country has been development oriented. It stands as a major support to those projects which often fail to catch the eye of investing public. These projects rank high from the points of view of national importance e.g. steel, fertilizer, and generally receive higher priority by such underwriters.

Thus institutional underwriting may be broadly recognised, in the context of development credit, as playing a decisive role in directing the economic resources of the country towards desired activities.

This does not mean that they are barred entrance in the issue market from so called glamorous issues to which public can be expected to readily subscribe. They may be underwriting in such cases, but what is expected of them is their support to projects in the priority sector.

One of the principal advantages they offer is that resource-wise they are undoubted. They are in a position to fulfill their underwriting commitments even in the worst foreseeable situations.

The public financial institutions namely IDBI, IFCI, ICICI, LIC and UTI, underwrite a portion of the issued capital. Usually, the underwriting is done in addition to granting term finance by way of loans on debentures. These institutions are usually approached when one or more of the following situations prevail:

(i) The issue is so large that broker-underwriting may not be able to cover the entire issue.

(ii) The gestation period is long enough to act as distinctive

(iii) The project is weak, inasmuch as it is being located in a backward area.

(iv) The project is in the priority sector which may not be able to provide an attractive return on investment.

(v) The project is promoted by technicians.

(vi) The project is new to the market.

The quantum of underwriting assistance varies from institution to institution according to the commitments of each of them for a particular industry.

However, institutional underwriting suffers from the following two drawbacks:

1. The institutional handling involves procedural delays which sometimes dampen the initiative of the corporate managers or promoters.

2. The other disadvantage is that the institutions prefer to wait and watch the results to fulfill their obligations only where they are called upon to meet the deficit caused by under subscription.

(c) Distribution :
The sale of securities to the ultimate investors is referred to as distribution; it is another specialised job, which can be performed by brokers and dealers in securities who maintain regular and direct contact with the ultimate investors. The ability of the New Issue Market to cope with the growing requirements of the expanding corporate sector would depend on this triple-service function.

2.4 METHODS OF FLOATATION

The Capital Market consists of development banks, commercial Banks and stock exchanges. There are various methods of floating new issues in the primary market :

- **Offer through Prospectus**

Offer through prospectus is the most popular method of raising funds by public companies in the primary market. After a prospectus is issued, the public subscribes to shares, debentures, etc. This involves inviting subscription from the public through the issue of the prospectus. A prospectus makes a direct appeal to investors to raise capital, through an advertisement in newspapers and magazines. As per the response, shares are prearranged to the public. If the subscriptions are very high, the allocation will be done on lottery or pro-rata basis.

It provides such information as the reason for which the fund is being raised, the company's background and upcoming projection, it's a precedent financial performance, etc.

- **Offer for Sale**

Institutional investors like business enterprise funds, private equity funds, etc., invest in an unlisted company when it is very small or at an early stage. Under this method, securities are not issued directly to the public but are offered for sale through intermediaries like issuing houses or stock brokers.

Consequently, when the company becomes big, these investors sell their shares to the public, through the issue of the offer document and the company's shares are listed in the stock exchange. This is called an offer for sale. The advantage of this technique is that the company need not be bothered about the printing and advertisement of the prospectus, allocation of shares, etc.

- **Private Placement**

A private placement is the allotment of securities by a company to institutional investors and some selected individuals. Public offers are an exclusive concern. The subsidiary cost of IPO's lean to be very high. This is why some companies favor not to go down this route. It helps to raise capital more quickly than a public issue. They offer investment opportunities to a select few individuals. The private placement is the contradictory of a public issue, in which securities are made accessible for sale on the open market.

So the company will sell its shares to economic institutes, banks, insurance companies, and some select individuals. This will help them raise the funds competently, rapidly and efficiently. Such companies do not sell or offer their securities to the public at large. Financial institutions, mutual funds, investment bank, etc. subscribe to placement orders.

- **Rights Issue**

Usually, when a company is looking to expand or are in need of supplementary funds, they first turn to their present investors. This is a privilege given to existing shareholders to subscribe to a new issue of shares according to the terms and conditions of the company. So the present shareholders are given a prospect to further invest in the company. They are given the "right" to buy new shares before the public is offered the chance.

Such shares are marketable in the market by the owners. Successful companies assume this technique for fundraising. The rights issue is advantageous to the company as the cost of issue is minimum.

- **e-IPOs**

It stands for Electronic Initial Public Offer. A company proposing to issue capital to the public through the online system of the stock exchange has to enter into an agreement with the stock exchange. When a company wants to offer its shares to the public it can now also do so online. This is called an Initial Public Offer (IPO). An agreement is signed between the company and the related stock exchange known as the e-IPO. Issuing company also require to assign registrar to have electronic connectivity with the exchange.

2.5 PRICING OF ISSUES

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

a. First issue of new companies set up by existing companies with the track record.
b. First issue of existing private/closely held or other existing unlisted companies with three-year track record of consistent profitability.
c. First public issue by existing private/closely held or other existing unlisted companies without three year track record but promoted by existing companies with a five-year track record of consistent profitability.
d. Existing private/closely held or other existing unlisted company with three-year track record of consistent profitability, seeking disinvestments by offers to public without issuing fresh capital (disinvestments).
e. Public issue by existing listed companies with the last three years of dividend paying track record. At par value: The price of the share should be at par in case of: a) First public issue by existing private, closely held or other existing unlisted companies without three year track record of consistent profitability and
f. Existing private/closely held and other unlisted companies without three-year track record of consistent profitability seeking disinvestments offer to public without issuing fresh capital (disinvestments).

2.6 UNDERWRITING OF ISSUES AND ALLOTMENT OF SHARES

Meaning of Underwriting:

‘Underwriting’ refers to the functions of an under-writer. An under-writer may be an individual, firm or a joint stock company, performing the under-writing function. Under-writing may be defined as a contract entered into by the company with persons or institutions, called under-writers, who undertake to take up the whole or a portion of such of the offered shares or debentures as may not be subscribed for by the public. Such agreements are called ‘Under-writing agreement’.

A newly formed company enters into an agreement with an under-writer to the effect that he will take up shares or Debentures offered by it to the public but not subscribed for in fully by the public. Such an agreement may become necessary when a company issues shares or debentures for the first time to the public, or subsequently when it is in need of working capital.

When the company does not receive 90 per cent of issued amount from public subscription, within 120 days from the date of opening the issue, the company cannot proceed with allotment. In such a case, the company must refund the amount of subscription. In the case of a new company, it cannot obtain a certificate to commence function.

A company is not sure whether the shares or debentures offered for subscription may be taken up by the public. There arises a risk to ensure the success of issue. Therefore, companies resort to underwriting in order to ensure that sufficient number of shares or debentures would subscribed for. Thus, risk-bearing or uncertainty bearing is an important function of an underwriter.

Thus, an underwriter is a person who undertakes to take up the whole or a portion of the shares or debentures offered by a company to the public for subscription as may not be subscribed for by the public, prior to making such an offer. The company has to pay a commission to such an underwriter. It is known as underwritingcommission. It is, of course, a type of insurance against under-subscription.

ALLOTMENT OF SHARES

Allotment of shares is an appropriation of a certain number of shares to an applicant and distribution of shares among those who have submitted written application. It is governed by companies act, 2013 and rules & regulations incorporated therein and for Listed Companies) whose shares are listed on the NSE and BSE or any other applicable Stock exchanges in India and whose shares are freely tradable without any restrictions) and Subsidiary of Listed Companies the provisions of SEBI act, 1992 and the securities contracts (regulation) act, 1956, are also applicable

MODE OF ALLOTMENT OF SHARES:

- A public company may allot shares in the following ways:
  a. to public through prospectus (public offer)
  b. through private placement
  c. through a rights issue or a bonus issue

- A private company may allot shares in the following ways:
  a. through a rights issue or a bonus issue
  b. through private placement/ preferential Allotment

PUBLIC OFFER:
An application is made to stock exchange(s) for the shares to be dealt through it/ them, before any offer of allotment to public. Allotment of shares is always in e-materialized form and the offer for the allotment of shares is made through red herring/ shelf prospectus, as the case may be. In public offer, no allotment is made unless minimum amount stated in the prospectus has been subscribed and consequently return of allotment is to be filed with the registrar.

PRIVATE PLACEMENT/ PREFERTIAL ALLOTMENT:
A private placement offer letter is issued to such number of persons not exceeding 50 but limited to 200 in a financial year and the allotment of shares through private placement is to be approved by the shareholders through a special resolution only. A complete record of private placement offers is to be kept by the company and is to be filed with the registrar and to SEBI (for listed company).

RIGHTS ISSUE:
A letter of offer in the form of notice is issued to the existing equity shareholders for the purpose of rights issue which provides with the right of renunciation to the existing equity shareholders w.r.t. the offer for the allotment of shares. Accordingly, subscribed capital of the company is increased in rights issue.

BONUS ISSUE:
Only fully paid-up bonus shares are issued to the members, out of:

a. free reserves
b. securities premium account; or
c. capital redemption reserve account, maintained by the company in this regard

Bonus issue is to be authorized by the AOA of the company making the allotment of bonus shares and it is recommended by the board and then approved by the shareholders in the general meeting of the company.

2.7. THIRD PARTIES INVOLVED IN ISSUES

Managers to the issue: Lead managers are appointed by the company to manage the public issue programmes. Their main duties are (a) drafting of prospectus (b) preparing the budget of expenses related to the issue (c) suggesting the appropriate timings of the public issue (d) assisting in marketing the public issue successfully (e) advising the company in the appointment of registrars to the issue, underwriters, brokers, bankers to the issue, advertising agents etc. and (f) directing the various agencies involved in the public issue. There are many agencies which are performing the role of lead managers to the issue. The merchant banking division of the financial institutions, subsidiary of commercial banks, foreign banks, private sector banks and private agencies are available to act as lead managers.

Registrar to the issue: In consultation with the lead manager, the Registrar to the issue is appointed. Quotations containing the details of the various functions they would be performing and charges for them are called for selection. Among them the most suitable one is selected. It is always ensured that the registrar to the issue has the necessary infrastructure like computer, internet and telephone.

The Registrars to the issue normally receive the share application from various collection centres. They recommend the basis of allotment in consultation with the Regional Stock Exchange for approval. They arrange for the dispatching of the share certificates. They handover the details of the share allocation and other related registers to the company. Usually registrars to the issue retain the issuer records at least for a period of six months from the last date of dispatch of letters of allotment to enable the investors to approach the registrars for redressal of their complaints.

Underwriters: Underwriter is a person/organization who gives an assurance to the issuer to the effect that the former would subscribe to the securities offered in the event of non-subscription by the person to whom they were offered. They stand as back-up supporters and underwriting is done for a commission. Underwriting provides an insurance against the possibility of inadequate subscription. Some of the underwriters are financial institutions, commercial banks, merchant bankers, members of the stock exchange, Export and Import Bank of India etc. The underwriters are exposed to the risk of non subscription and for such risk exposure they are paid an underwriting commission.

When appointing an underwriter, the financial strength of the prospective underwriter is considered because he has to undertake the agreed non-subscribed portion of the public issue. The other aspects considered are

a. experience in the primary market
b. past underwriting performance and default
c. outstanding underwriting commitment
d. the network of investor clientele of the underwriter and
e. his overall reputation.

Bankers to the issue: The responsibility of collecting the application money along with the application form is on bankers to the issue. The bankers charge commission besides the brokerage, if any. Depending upon the size of the public issue more than one banker to the issue is appointed. When the size of the issue is large, three or four banks are appointed as bankers to the issue. The number of collection centres is specified by the central government. The bankers to the issue should have branches in the specified collection centres. In big or metropolitan cities more than one branch of the various bankers to the issue are designated as collecting branch for acceptance of money. To create investment awareness in the minds of the people collecting branches are designated in the different towns of the state where the project is being set up. If the collection centres for application money are located nearby people are likely to invest the money in the company shares.

Advertising agents: Advertising a public issue is very essential for its promotion. Hence, the past track record of the advertising agency is studied carefully. Tentative programmes of each advertising agency along with the estimated cost are called for. After comparing the effectiveness and cost of each programme with the other, a suitable advertising agency is selected in consultation with the lead managers to the issue. The advertising agencies take the responsibility of giving publicity to the issue on the suitable media. The media may be newspapers /magazines/ hoardings/press release or a combination of all.

The financial institutions: The function of underwriting is generally performed by financial institutions. Therefore, normally they go through the draft of prospectus, study the proposed programme for public issue and approve them. IDBI, IFCI, ICICI, LIC, GIC and UTI are the some of the financial institutions that underwrite and give financial assistance. The lead manager sends copy of the draft prospectus to the financial institutions and include their comments, if any in the revised draft.

UNIT 3:
Unit structure:

3.1 Learning Outcomes
3.2 Meaning and fuctions of Stock Exchanges
3.3 Importance and Limitations of Stock Exchanges
3.4 Mechanics of Stock Market Trading
3.5 Different Types of Orders
3.6 Settlement Procedure
3.7 Types of Brokers
3.8 Listing of Securities in Indian Stock Exchanges

3.1 LEARNING OUTCOMES:

- An introduction about trading will freshen their knowledge about a different type of investment.
- This chapter will provide an elaborate information on the history of stock exchanges and how stock trading began.

3.2 **MEANING AND FUNCTIONS OF STOCK EXCHANGES:**

A stock exchange is a marketplace, where financial securities issued by companies are bought and sold. They are part of the broader capital market ecosystem. Securities issued by companies, such as shares and bonds, are traded on the stock exchanges, after they have been issued in the primary market.

A company, desirous of listing its securities on a stock exchange, has to enter into an agreementwith the exchange to ensure that its securities are allowed for trading on that particular exchange. Stock exchanges play a key role in creating liquidity for financial securities. Securities trading on stock exchanges, is based on an order matching algorithm, which ensures that the best buy order matches with the best sell order.

Stock exchanges earn money by charging a fee to the trading members. In India BSE, formerly known as Bombay Stock Exchange, and National Stock Exchange are two main stock exchanges.

Functions of Stock Exchange

Following are some of the most important functions that are performed by stock exchange:

1. **Role of an Economic Barometer:** Stock exchange serves as an economic barometer that is indicative of the state of the economy. It records all the major and minor changes in the share prices. It is rightly said to be the pulse of the economy, which reflects the state of the economy.
2. **Valuation of Securities:** Stock market helps in the valuation of securities based on the factors of supply and demand. The securities offered by companies that are profitable and growth-oriented tend to be valued higher. Valuation of securities helps creditors, investors and government in performing their respective functions.
3. **Transactional Safety:** Transactional safety is ensured as the securities that are traded in the stock exchange are listed, and the listing of securities is done after verifying the company's position. All companies listed have to adhere to the rules and regulations as laid out by the governing body.
4. **Contributor to Economic Growth:** Stock exchange offers a platform for trading of securities of the various companies. This process of trading involves continuous disinvestment and reinvestment, which offers opportunities for capital formation and subsequently, growth of the economy.
5. **Making the public aware of equity investment:** Stock exchange helps in providing information about investing in equity markets and by rolling out new issues to encourage people to invest in securities.
6. **Offers scope for speculation:** By permitting healthy speculation of the traded securities, the stock exchange ensures demand and supply of securities and liquidity.
7. **Facilitates liquidity:** The most important role of the stock exchange is in ensuring a ready platform for the sale and purchase of securities. This gives investors the confidence that the existing investments can be converted into cash, or in other words, stock exchange offers liquidity in terms of investment.
8. **Better Capital Allocation:** Profit-making companies will have their shares traded actively, and so such companies are able to raise fresh capital from the equity market. Stock market helps in better allocation of capital for the investors so that maximum profit can be earned.
9. **Encourages investment and savings:** Stock market serves as an important source of investment in various securities which offer greater returns. Investing in the stock market makes for a better investment option than gold and silver.

3.3 IMPORTANCE & LIMITATIONS OF STOCK EXCHANGE

Importance of Stock Exchange:

The stock exchange is the mirror of the economy of any country. It helps industries and commerce to develop a country. In this regard the importance of stock exchange is massive. To make a country economically strong and dynamic there is no alternative to the stock exchange. The importance of the stock exchange are given below:

Formation of capital: To form the capital for industries, it plays the key role. Though banks and other financial institutions help to form capital but among them stock exchange is vital for collecting long-term huge capital.

Inspiring savings: Stock exchanges inspire individuals to reducing current consumption and inspire to increases savings. By this means individuals can be benefited and thus the industries as well.

The mobility of resources: It makes the economy dynamic by helping in a proper mobilization of resources from households to companies. Mobilization of resources is highly required for any country's economic development.

Helping in industrialization: It helps in industrialization. Stock exchange provides the required capital for the industries. The companies can easily collect the necessary amount of capital by issuing shares or selling debentures in the stock market.

Improving living standard: It creates attractive investment sectors for the mass people. One can gain easily by investing his savings in the market. Thus the stock market helps in improvement of living standard of general people.

Strong economic base: It helps industrialization through mobilization of resources. Thus it makes the economy strong. For a strong economy, the industrial development is essential and the stock exchange act here effectively.

Safety of investment: It secures the investment. Stock exchange maintains rules and regulation to guard the market against fraudulence.

Proper valuation of share and security: It has specific rules for valuation for the stocks and securities. It publishes the daily transaction from that the investors can be aware of the price of shares and securities.

Ready market: Stock exchange is ready and a secondary market. Like product and service market, one can buy and sell financial products from and to the stock market. The stock market is almost a financial product-oriented market.

Proper utilization of savings: Stock exchange helps the proper utilization of savings of general people. It brings the savings and form capital for the companies, thus utilizes properly the savings.

After all, the stock exchange is an important economic institution. It helps both the investors and the companies for mutual benefits. It deals with great importance to the development of the economy of a country.

LIMITATIONS OF STOCK EXCHANGE:

Lack of Professionalism: The majority of stock brokers lack professionalism. They lack proper education, business skills, infra-structural facilities etc. which inhibits them to provide proper service to clients. They are not able to guide and counsel their clients in the manner expected of them.

Domination of Financial Institutions:Indian stock markets are dominated by a few financial institutions. The U.T.I., LIC, GIC are the main players in Indian stock markets. The buying and selling by these institutions sets the tone in the market. The market goes bullish if financial institutions start buying shares; on the other hand, it becomes bearish on their selling spree.Under SEBI guidelines, a member of mutual funds have been registered but they are concentrating more on new issues (primary market) Financial institutions in development economics to enter stock markets but their number is large and few institutions cannot influence the whole market as is done in India by three main institutions.Moreover, Indian financial institutions indulge more in buying and less in selling. With the entry of more and more Indian and foreign institutions, their influence in stock markets will gradually decline.

Poor Liquidity:The Indian stock exchanges suffer from poor liquidity. A small number of scrips are regularly traded on stock exchanges. Out of over 3,000 scrips less than 500 scrips are generally traded and even out of these 90 percent volume of trade confines to between 200-250 scrips. This means that other scrips have very low liquidity.A recent survey into frequency of trading showed that shares of 207 companies were traded every day, shares of 538 Companies were traded once a week, shares of 396 Companies were traded once of fortnight, shares of 954 Companies were traded once a month and shares of 959 companies were traded once a year.

Domination by Big Operators*:*Some big operators influence the sentiment of stock exchanges in India. In Bombay Stock Exchange 3-4 operators used to call the shots. The case of Harshad Mehta is well known in India. He created bullish conditions in Indian stock exchanges in the first quarter of 1992 and BSE sensex nearly doubled in a very short period.This artificial increase in prices of shares adversely affected the investing public and people suffered huge losses. It is the weakness of stock exchange’s working that some operators can create the sentiment as per their liking.

Less Floating Stocks:There is a scarcity of floating stock in Indian stock exchanges. The shares and debentures offered for sale are a small portion of total stocks. The financial institutions and joint stock companies which control over 75 percent of the scrips do not offer them for sale. The U.T.I, G.I.C., L.I.C., etc. indulge more in purchasing than in selling. It creates scarcity of stocks for trading. The markets tend to be violative and amenable to manipulations in the absence of adequate floating stocks for trading.

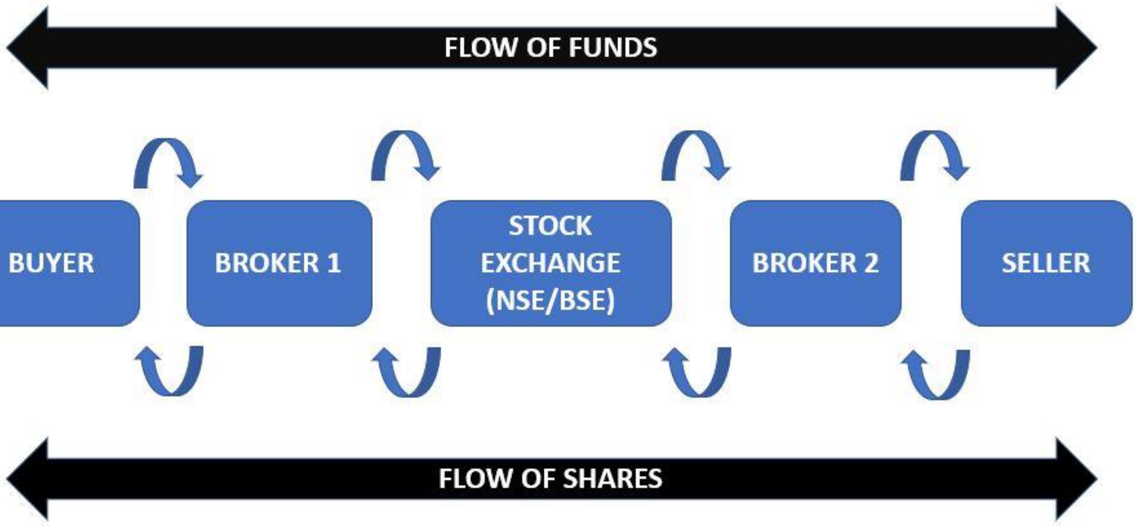
Speculative Trading:The trading in stock exchanges is mainly speculative in nature. The operators try to derive benefit out of short-term price fluctuations. At Bombay Stock Exchange upto 5 percent and at other exchanges upto 10 percent transactions are genuine investment deals. The brokers try to create a sentiment in the market which will be beneficial to them. The genuine investors try to keep away from such markets.

3.4 MECHANICS OF STOCK MARKET TRADING

Trading Mechanism in Stock Exchange

Once the Demat account and Trading account are ready, all set to trade in the stock market. Companies list their shares in the Primary Market through an Initial Public Offering Or IPO. After the IPO the stocks of the company are listed on an exchange and are available for trading in the secondary market.

Stocks of companies are traded in order to make profits or cut down losses. This trading of stocks is carried out through a stockbroker or brokerage firm. These brokers act as an intermediary body between the person trading and the stock exchange.



Whenever trader wants to buy and trade a stock, the person place the order with a broker at a fixed price. The broker passes on the order to the stock exchange. The exchange then searches for availability of buyer or seller to execute the order at the instructed price. If the order is completed the exchange communicated with the broker that the order has been executed.

The stock exchanges keep record of all the details of buyers and sellers trading on the exchange through the brokers to avoid any chance of default. The stocks are then transferred from the Demat account of the seller to the Demat account of the buyer electronically. The settlement process earlier used to take weeks, but the electronic settlement and introduction of Demat has made it possible to carry out all settlements in T+2 days.

3.5 DIFFERENT TYPES OF ORDERS

Market Order

A market order is a trade order to purchase or sell a stock at the current market price. A key component of a market order is that the individual does not control the amount paid for the stock purchase or sale. The price is set by the market. A market order poses a high slippage risk in a fast-moving market. If a stock is heavily traded, there may be trade orders being executed ahead of yours, changing the price that you pay.

For example, if an investor places an order to purchase 100 shares, they receive 100 shares at the stock’s asking price.

2. Limit Order

A limit order is a trade order to purchase or sell a stock at a specific set price or better. A limit order prevents investors from potentially purchasing or selling stocks at a price that they do not want. Therefore, in a limit order, if the market price is not in line with the limit order price, the order will not execute. A limit order can be referred to as a buy limit order or a sell limit order.

A buy limit order is used by a buyer and specifies that the buyer will not pay more than Rs.x per share, with Rs.x being the limit order set by the buyer.

For example, consider a stock whose price is Rs.11. An investor sets a limit order to purchase 100 shares at Rs.10. In this scenario, only when the stock price hits Rs.10 or lower will the trade execute.

A sell limit order is used by a seller and specifies that the seller will not sell a share under the price of Rs.x per share, with Rs.x being the limit order set by the seller.

For example, consider a stock whose price is Rs.11. An investor sets a limit order to sell 100 shares at Rs.12. In this scenario, only when the stock price hits Rs.12 or higher will the trade execute.

3. Stop Order

A stop order also referred to as a stop-loss order, is a trade order designed to limit (and therefore protect) an investor's loss on a position. A stop order sells a stock when it reaches a certain price. Although a stop order is generally associated with a long position, it can also be used with a short position. In that case, the stock will be purchased if it trades above the stop order price.

For example, an investor is considering selling its position in a stock if it declines to Rs.8 from its current price of Rs.12. The investor could place a stop order at Rs.8. When the stock hits Rs.8, the order would be executed.

Note that the stock will not necessarily sell at exactly Rs.8 – it depends on the supply and demand of the stock. If the stock price is rapidly falling, the order may be executed at a price significantly lower than Rs.8. This type of problem can be minimized by a stop-limit order.

4. Stop-Limit Order

A stock-limit order is a conditional trade order that combines the features of a stop and limit order. A stop-limit order requires placing two prices – the stop price and the limit price. Once the stock hits the stop price, the order becomes a limit order. Stop-limit orders, as opposed to a stop order, guarantee a price limit. On the other hand, a stop order guarantees an order execution but not necessarily at the stop order price.

For example, an investor currently owns a stock trading at Rs. 30. The investor would like to sell the stock if it dips below $25, but only if the stock can be sold at Rs.24 or more. The investor sets a stop-limit order by setting a stop price of $25 and a limit price of Rs.24. Once the stock drops below Rs.25, the order becomes a Rs.24 limit order.

5. Trailing Stop Order

A trailing stop order is similar to a stop order. However, a trailing stop order is based on the percentage change in market price as opposed to a specific target price. Although a trailing stop order is generally associated with a long position, it can also be used with a short position. In such a case, the stock will be purchased if it increases by a determined percentage.

For example, an investor purchases a stock at a price of Rs.10. The investor places a trailing stop order of 20%. If the stock declines 20% or more, the order will be executed.

3.6 SETTLEMENT PROCEDURE

Trading and Settlement Procedure

1. Selecting a Broker or Sub-broker: When a person wishes to trade in the stock market, it cannot do so in his/her individual capacity. The transactions can only occur through a broker or a sub-broker. So according to one's requirement, a broker must be appointed.

Now such a broker can be an individual or a partnership or a company or a financial institution (like banks). They must be registered under SEBI. Once such a broker is appointed you can buy/sell shares on the stock exchange.

2] Opening a Demat Account: Since the reforms, all securities are now in electronic format. There are no issues of physical shares/securities anymore. So an investor must open a dematerialized account, i.e. a Demat account to hold and trade in such electronic securities.

So you or your broker will open a Demat account with the depository participant. Currently, in India, there are two depository participants, namely Central Depository Services Ltd. (CDSL) and National Depository Services Ltd. (NDSL).

3] Placing Orders: And then the investor will actually place an order to buy or sell shares. The order will be placed with his broker, or the individual can transact online if the broker provides such services. One thing of essential importance is that the order /instructions should be very clear. Example: Buy 100 shares of XYZ Co. for a price of Rs. 140/- or less.

Then the broker will act according to your transactions and place an order for the shares at the price mentioned or an even better price if available. The broker will issue an order confirmation slip to the investor.

4] Execution of the Order: Once the broker receives the order from the investor, he executes it. Within 24 hours of this, the broker must issue a Contract Note. This document contains all the information about the transactions, like the number of shares transacted, the price, date and time of the transaction, brokerage amount, etc.

Contract Note is an important document. In the case of a legal dispute, it is evidence of the transaction. It also contains the Unique Order Code assigned to it by the stock exchange.

5] Settlement: Here the actual securities are transferred from the buyer to the seller. And the funds will also be transferred. Here too the broker will deal with the transfer. There are two types of settlements,

- On the Spot settlement: Here we exchange the funds immediately and the settlement follows the T+2 pattern. So a transaction occurring on Monday will be settled by Wednesday (by the second working day)

- Forward Settlement: Simply means both parties have decided the settlement will take place on some future date. It can be T+% or T+9 etc.

3.7 TYPES OF BROKERS

There Are Basically Two Types Of Stock Brokers:

Full-Service Broker: A full service brokeroffers a broad range of stock and share trading services to the clients together with researching on different stocks and sharesand presenting recommendation on potential profit-making stocks.
Their roles comprise researching the stock market in which the client wants to invest in, study the trend and investigate the different patterns and offer recommendations on which stock the client can invest it and consequently make a profit out of it.
Other than offering advice, they also use their expertise in buying and selling different stocks and shares and stay up to date on the progress taking place in the stock market.
As full-service brokers carry out most of the work for their clients, their brokerage fee or commission is generally high.
Discount Broker: As contrasting to the full-service broker, a discount broker focuses only in executing buying and selling orders for their clients.
They perform the trade by charging a brokerage feemuch less than what is paid for their full-service counterparts.
Such discount brokers do not offer any recommendations on the investment nor do they offer any recommendations to their clients.

3.8 LISTING OF SECURITIES IN STOCK EXCHANGES

Listing of Securities

Listing means the admission of securities of a company to trading on a stock exchange. Listing is not compulsory under the Companies Act. It becomes necessary when a public limited company desires to issue shares or debenturesto the public. When securities are listed in a stock exchange, the company has to comply with the requirements of stock exchange.

Objectives of Listing

The major objectives of listing are

1. To provide ready marketability and liquidity of a company’s securities.

2. To provide free negotiability to stocks.

3. To protect shareholders and investors interests.

4. To provide a mechanism for effective control and supervision of trading.

Listing requirements

A company which desires to list its shares in a stock exchange has to comply with the following requirements:

1. Permission for listing should have been provided for in the MOAand AOA
2. The company should have issued for public subscription at least the minimum prescribed percentage of its share capital (49 percent).

3. The prospectus should contain necessary information with regard to the opening of subscription list, receipt of share application etc.

4. Allotment of shares should be done in a fair and reasonable manner. In case of over subscription, the basis of allotment should be decided by the company in consultation with the recognized stock exchange where the shares are proposed to be listed.
5. The company must enter into a listing agreement with the stock exchange. The listing agreement contains the terms and conditions of listing. It also contains the disclosures that have to be made by the company on a continuous basis.

Minimum Public Offer

A company which desires to list its securities in a stock exchange, should offer at least sixty percent of its issued capital for public subscription. Out of this sixty percent, a maximum of eleven percent in the aggregate may be reserved for the Central government, State government, their investment agencies and public financial institutions.

The public offer should be made through a prospectus and through newspaper advertisements. The promoters might choose to take up the remaining forty percent for themselves, or allot a part of it to their associates.

Fair allotment

Allotment of shares should be made in a fair and transparent manner. In case of over subscription, allotment should be made in an equitable manner in consultation with the stock exchange where the shares are proposed to be listed.

In case, the company proposes to list its shares in more than one exchange, the basis of allotment should be decided in consultation with the stock exchange which is located in the place in which the company's registered office is located.

Listing Procedure:

The following are the steps to be followed in listing of a company's securitiesin a stock exchange:
1. The promoters should first decide on the stock exchange or exchanges where they want the shares to be listed.

2. They should contact the authorities to the respective stock exchange/ exchanges where they propose to list.

3. They should discuss with the stock exchange authorities the requirements and eligibility for listing.

4. The proposed Memorandum of Association, Articles of Association and Prospectus should be submitted for necessary examination to the stock exchange authorities

5. The company then finalizes the Memorandum, Articles and Prospectus

6. Securities are issued and allotted.

7. The company enters into a listing agreement by paying the prescribed fees and submitting the necessary documents and particulars.

8. Shares are then and are available for trading.

UNIT 4
Unit Structure:

4.1 Learning Outcomes
4.2 Trading Pattern in OTCEI
4.3 Procedure of Listing and Trading on OTC
4.4 NSE Meaning, Significance and Functions
4.5 Capital Market Segment
4.6 Security Market Indicators
4.7 BSE, NSE, NIFTY, SENSEX

4.1 LEARNING OUTCOMES

- Students will be able to learn and understand all the basic knowledge required to be known before starting to trade.
- The market indicators will provide adequate knowledge about the movement of the market and its fluctuations.

4.2 TRADING PATTERN IN OTCEI

Definition of OTCEI

Over The Counter Exchange of India (OTCEI) can be defined as a stock exchange without a proper trading floor. All stock exchange have a specific place for trading their securities through counters. But the OTCEI is connected through a computer network and the transactions are taking place through computer operations. Thus, the development in information technology has given scope for starting this type of stock exchange.

OTCEI is recognized under the Securities Contract and Regulation Actand so all the stocks listed in this exchange enjoy the same benefits as other listed securities enjoy.

Need for starting OTCEI:

Many small companies in India are finding it difficult to raise adequate capital through Stock Exchanges as the conditions stipulated by them could not be fulfilled. The companies must have run for minimum three years and they must have earned profit and the minimum capital requirement for listing is also quite high. Hence by promoting a new Stock exchange with flexible conditions, the small and medium companies in India will be able to raise sufficient capital. Once these companies enlarge their resources, they can list themselves in the regular stock exchanges.

Promotion of OTCEI:

OTCEI has been incorporated under Section 25 of the Companies Act. As a result of which the word 'Limited' need not be used since it is promoted for a common cause of promoting the interest of small and medium companies. This privilege has been given to the company by the Central Government.

This company was promoted by a group of financial institutions owned by the Government of India, consisting of UTI, ICICI, IDBI, SBI Capital Market, IFCI, LIC, GIC; and Can Bank Financial Services (which is a subsidiary of Canara Bank).

Special features of OTCEI:

1. **Use of Modern technology:** Unlike other stock market, OTCEI does not have any special counters and it is an electronically operated stock exchange.
2. **Restrictions for other stocks:** Stocks and shares listed in other stock exchanges will not be listed in the OTCEI and similarly, stocks listed in OTCEI will not be listed in other stock exchanges.
3. **Minimum issued capital requirements:** Minimum issued equity capital should be Rs. 30 Lakhs, out of which minimum public offer should be Rs. 20 Lakhs.
4. **Restrictions for large companies:** No company with the issued equity share capital of more than Rs. 25 Crores is permitted for listing.
5. **Base Capital requirement for members:** Members will be required to maintain a minimum base capital of Rs. 4 Lakhs to trade on the permitted or on listed segment.
6. **All India Network:** The network of counters links OTCEI members, located in different parts of the country.
7. **Satellite facility**: The satellite required for OTCEI for its operations is jointly held with Press Trust of India (PTI) and hence, PTI-OTCEI scan displays the prices of OTCEI's scripts.

8. **Computerization of transactions:** Computers at each counter enable to dealers to enter various transactions or queries or quotes through a central OTCEI computer, using telecommunications links.
Due to the above features, OTCEI has an edge over other stock exchanges in the country.

Constituents of OTCEI
OTCEI commenced its operations in 1992. In OTCEI, we have the following parties taking part in various transactions. They are

- Companies
- Dealers
- Members
- Investors
- Custodian or Settlers
- Transfer agents
- OTCEI
- Government and
- SEBI.

4.3 PROCUDEURE OF LISTING AND TRADING ON OTC

Transactions done in OTCEI
The members of the OTCEI will invite companies to list on the exchange for raising capital. There are dealers who perform the dual role of a broker and market maker. A broker acts on behalf of buyer or seller, while a market maker has a responsibility to make available toe particular share in the maker for transactions and to maintain reasonable price through supply and demand forces.

Example: The market makers will prevent abnormal fluctuations in the price of securities by regulating the supply and demand forces of securities in such a manner than acute scarcity or abundant supply of any security will be avoided. If 1000 shares are demanded among different categories so that the price will not fluctuate abnormally.

The custodian or a settler is one who validates the trading documents, stores the trading documents and also arranges for the clearing of daily transaction. It is the settler who gives the net monetary position of each member with regard to the market as a whole. The registrar and transfer agents ensure share transfers and allotments of shares and also inform the developments of various companies in the market.

Listing requirements in OTCEI

For any company to list its shares in OTCEI, it requires sponsorship by members of the OTCEI and it must also have two market makers. The OTCEI has also laid down rules regarding listing requirements.

- Once a company lists its securities in the market, it cannot delist its securities for a minimum period of 3 years.
- There are certain norms to be fulfilled by companies for sale of equity shares or any other securities under bought out deal (i.e., a company at its early stage may issue shares with an understanding that it will buy back after 5 years at the market price from out of its profits.)
- 20% of the issued capital should be retained by the promoters for a period of not less than 3 years.
- There should be two market makers as per the guidelines of OTCEI.

4.4 NSE- MEANING, FUNCTIONS, SIGNIFICANCE

The National Stock Exchange of India Limited (NSE) is the largest financial exchange in the Indian market. It was established in 1992 on the recommendation of the High-Powered Study Group, which was founded by the Indian government to provide solutions to simplify participation in the stock market and make it more accessible to all interested parties. In 1994, the NSE introduced electronic trading in the Indian stock exchange market.

The National Stock Exchange of India Limited offers a platform to companies for raising capital. Investors can access equities, currencies, debt, and mutual fund units on the platform. In India, foreign companies can raise capital using the NSE platform through initial public offerings, Indian Depository Receipts (IDRs), and debt issuances. The NSE also offers clearing and settlement services.

The order-driven exchange market displays every sell and buy order in the system; thus, it provides transparency to the investors. Customers can be provided the online trading facility by brokers, who place the orders in the trading system. Except for the holidays declared by the NSE, the exchange market is available five days a week, from Monday to Friday.

NSE Functions

- To establish a trading facility for debt, equity, and other asset classes accessible to investors across the nation.
- To act as a communication network providing investors an equal opportunity to participate in the trading system.
- To meet the global standards set for financial exchange markets.
- To provide a shorter trade settlement period and enable the book-entry settlement system.

NSE Listing Benefits

- Investors can get trade and post-trade information through the NSE trading system. They can see the top sell orders and buy orders, as well as the number of securities available for transactions.
- The trading expenses of investors are reduced as the impact cost on the trading activity decreases owing to the volume of the trading activity.
- The trading system of the NSE processes the transaction at a pace that allows the investors to get the best prices.
- The NSE provides monthly trade statistics to the listed companies. The companies can utilize the data to track their performance.
- The electronic system of trading provides investors with a transparent and effective exchange market.

4.5 MARKET INDICATORS

Market indicators are quantitative in nature and seek to interpret stock or financial index data in an attempt to forecast market moves. Market indicators are a subset of technical indicators and are typically comprised of formulas and ratios. They aid investors' investment/trading decisions.

Market indicators are similar to technical indicatorsin that both apply a statistical formula to a series of data points to draw a conclusion. The difference is that market indicators use data points from multiple securities rather than just a single security. Often times, market indicators are plotted on a separate chart rather than appearing above or below an index price chart.

Most stock market indicators are created by analyzing the number of companies that have reached new highs relative to the number that created new lows, known as market breadth, since it shows where the overall trend is headed.

The two most common types of market indicators are:

- **Market Breadth** indicators compare the number of stocks moving in the same direction as a larger trend. For example, the Advance-Decline Linelooks at the number of advancing stocks versus the number of declining stocks.
- **Market Sentiment** indicators compare price and volume to determine whether investors are bullish or bearish on the overall market. For example, the Put Call Ratio looks at the number of put options versus call options during a given period.

4.6 NIFTY & SENSEX

While BSE and NSE are stock markets, both Sensex and Nifty are stock market indices. A stock market index statistically summarises the movements of the market in real-time. A stock market index is created by selecting similar kinds of stock from a market or exchange and grouping them together. Sensex, which stands for 'Stock Exchange Sensitive Index', is the stock market index for the Bombay Stock Exchange. It calculates the movement on BSE. Nifty stands for 'National Stock Exchange Fifty' and is the index for the National Stock Exchange.

Sensex is derived from Sensitive and Index and is coined by Mr Deepak Mohoni, a stock market analyst. It is an index on the Bombay Stock Exchange or BSE. Sensex comprises 30 companies, and these are chosen based on the liquidity, market capitalisation, revenue, and diversification of the company. Also, for a company to be on Sensex, has to be listed on BSE.

It is one of India's oldest indices, and people consider it a measure of market performance and reflection of the Indian economy. It is used as a benchmark to gauge growth and development in the Indian economy and industry and understand the stock market trend.
Sensex comprises the top 30 stocks. The value of the index depends on the price movement of the underlying securities. An increase in the value of Sensex is due to an increase in the price of most of the securities. While a decrease in the value of the index is due to the fall in the price of most of the underlying securities.

NIFTY

Similar to the Sensex, Nifty is also an index. The National Stock Exchange is represented by Nifty. Nifty is a variation of the terms National and Fifty. The Nifty 50 is also a benchmark index, consisting of the top 50 stocks listed on the National Stock Exchange.
The top 50 stocks that comprise the Nifty 50 are from 12 different sectors. Some of these include information technology, consumer goods, financial services, automobiles, telecommunications, etc.
The companies to meet the following parameters and criteria to be part of the Nifty 50:

- **Liquidity:** The stock should have been traded at an average cost of 0.50% or less in the last six months.
- **Float Adjustment:** The float-adjusted market capitalisation of the company must be at least twice that of the current smallest index composition.
- **Domicile:** The company must be listed on the National Stock Exchange NSE and be an Indian company.

UNIT 5

Unit Structure:

5.1 LEARNING OUTCOMES

- Helps the students to understand the basic difference between demat account and mutual funds
- Helps them to diversify their investment options
- Gives them a clear picture of all the basic criteria required to be known before starting to trade.

5.2 DEMAT TRADING

Demat Account is an account that is used to hold shares and securities in electronic format. The full form of Demat account is a dematerialised account. The purpose of opening a demat account is to hold shares that have been bought or dematerialised (converted from physical to electronic shares), thus making share trading easy for the users during online trading.

In India, depositories such as NSDL and CDSL provide Free Demat Account services. Intermediaries, depository participants or stockbrokers—like Angel Broking—facilitate these services. Each intermediary may have Demat account charges that vary as per volume held in the account, type of subscription, and terms and conditions between a depository and a stockbroker.

Demat account

A Demat Account or Dematerialised Account provides the facility of holding shares and securities in an electronic format. During online trading, shares are bought and held in a Demat Account, thus, facilitating easy trade for the users. A Demat Account holds all the investments an individual makes in shares, government securities, exchange-traded funds, bonds and mutual funds in one place.

Dematerialisation

Dematerialisation is the process of converting the physical share certificates into electronic form, which is a lot easier to maintain and is accessible from anywhere throughout the world. An investor who wants to trade online needs to open a Demat with a Depository Participant (DP). The purpose of dematerialisation is to eliminate the need for the investor to hold physical share certificates and facilitating a seamless tracking and monitoring of holdings.

Types of Demat account

Essentially there are three types of Demat account:

1. Regular Demat account: Traders who reside in India use this type of account.
2. Repatriable Demat account: This is a Demat account which is useful to the Non-Resident Indians as it allows fund transfers abroad. Such a Demat account requires an associated NRE bank account.
3. Non-Repatriable Demat account: This account, too, is for the Non-Resident Indians. However, in this case, funds cannot be transferred abroad, and this account requires an associated NRO bank account.

Only trading account or only Demat account

The normal belief is that you need to open a trading account and a Demat account simultaneously. Actually, you can choose to open only one of these accounts. For example, if you want to invest in IPO then Demat account alone is sufficient. Once the shares are allotted to you, the shares will be credited to your Demat account. The only catch here is that you cannot sell the shares unless you have a trading account. Hence, you are buying shares purely with a view of holding them for the long term, then Demat account alone is sufficient. On the other, if you only want to trade in futures and options, then you need not open a Demat account. A trading account alone will be sufficient since F & O does not result in delivery. It is only when you want to hold equities that you require a Demat account.

Equity trading account and Commodity trading account

Your equity trading account is sufficient for trading in equities, futures and options. With regards to commodities, it is currently not possible to trade in commodities with your existing equity trading account. You will need a separate commodity trading account which you will have to open with your broker. This is largely due to the fact that commodities were under a different regulator in the past. It is only in the last 2 years that the FMC was merged into SEBI, and the commodity market regulation was also brought under SEBI. This could change as the regulator looks to further integrate the equities and commodities segments. It is interesting to note that currency derivatives can be dealt in your existing equity trading account itself.

Online versus Offline trading accounts: 2-in-1 account versus 3-in-1 account

Let us look at the primary classification here. Offline trading accounts are the traditional accounts that do not offer internet trading. You can call up your broker or walk into your broker’s office and trade. The online accounts, on the other hand, offer internet trading. That means you can execute your trades sitting in the comfort of your home or your office using your laptop, PC, or even your smartphone. An online account tends to attract lower brokerage and is also a lot more convenient and flexible for the trader.

Within the ambit of online trading accounts, let us also understand the difference between 2-in-1 accounts and 3-in-1 trading accounts. The 2-in-1 trading account basically integrates the trading account and the Demat account. Thus, when you buy shares in your trading account the movement into your Demat account on T+2 day is seamless. Similarly, when you sell shares, the debit to your Demat account on T+1 date is also seamless. The 3-in-1 account is offered by brokers that have banking operations within the group. Thus, ICICI Securities, HDFC Securities, Axis Securities, and Kotak Securities are all able to offer 3-in-1 accounts due to their banking interface. While 2-in-1 accounts are a must to ensure a seamless relationship between trading and demat, the 3-in- 1 is not a major advantage as most broking platforms will allow you to transfer funds almost seamlessly into your trading account.

Discount broking accounts versus full-service trading accounts

This distinction has gained prominence in the last couple of years with the emergence of discount brokers who trade huge volumes at a very low cost. These discount brokers do not offer any research or any add-on advisory services. They just offer plain execution of trades which is why they are able to offer services at a very low brokerage. Similarly, these discount brokers do not offer offline facility for placing trades except a call-and-trade facility, which is chargeable in most cases.
The full-service model will charge a higher brokerage but comes with a host of services. For example, there is research, short-term calls, advisory desk, and advisors to help you if you get stuck in positions. These are some of the premium services that you will get when you opt for a full-service trading account against a plain vanilla discount broking account. While the trading account enables you to trade on the BSE and the NSE, the commodity trading account enables you to trade on the NCDEX and the MCX. Remember, for commodity trading, you need to open a separate commodity trading account and a separate commodity Demat account.

5.3 SEBI GUIDELINES & OTHER REGULATIONS RELATING TO TRADING

When it comes to opening a Demat account in India, there are certain guidelines that need to be followed as per the Securities and Exchange Board of India (SEBI). SEBI guidelines for Demat accounts in India are with respect to opening the account, as well as closing it. These SEBI guidelines for Demat account are as follows:

SEBI guidelines for Opening a Demat account

To make the process uniform while ensuring the smooth submission of the right information, certain documents have to be submitted. These documents are government issued and are as follows:

- Application form that is duly filled

- Proof of address

- PAN card

- Bank Statement to link to one's bank account

As per SEBI guidelines for Demat account, one is required to submit all these documents to their broker or depository participant of their choosing. After one's application is processed by verifying and authenticating these documents, a Demat account will be opened in one's name.

It is possible to open more than one account in the same name with the same broker/DP or with a separate one. However, one has to fulfill all the KYC norms. This includes proof of identity and address proof, PAN and more, as stipulated by SEBI.

SEBI guidelines for Closing a Demat account

While there are no strict guidelines for closing a Demat account as per SEBI, some soft rules have to be followed for your depository participant to close your account. Here is the procedure for closing a Demat account in India.

- Filling out the necessary form required when one wish to closeaccount.

- Giving out the necessary information like person's DP's ID, Client ID, as well as any current information that should match the record.

- Proper reason to be given behind closing the account. It need not have a strong reason for , as whatever reason provided will serve as a form of feedback for the DP.

- As per the account details that are provided, any balance in theDemat account will be transferred.

- After a week to ten days the account will closed. Ensuring that one clears all leftover dues before choosing to close account, or the DP is required to keep the account operational.

General SEBI guidelines for Demat Account

The following guidelines are general recommendations by SEBI that apply to opening and running your Demat account in India. The goal with announcing these guidelines are to make the stock market a safer place. These guidelines need to constantly be updated and carefully monitored for any changes. SEBI continues to update the guidelines.

- All Demat account charges are predetermined so one can prevent stock brokers from overcharging.

- Verifying that the account holder is mandatory.

- It's compulsory as per SEBI guidelines for Demat account to link PAN card to Demat account as per KYC rules.

- To maintain aDemat account, no minimum amount is necessary.

- Annual charges need to be paid by the account holder as well as a percentage of trading as mandatory brokerage charges.

5.4 MUTUAL FUNDS

Mutual funds are one of the most popular investment options these days. A mutual fund is an investment vehicle formed when an asset management company(AMC) or fund house pools investments from several individuals and institutional investors with common investment objectives. A fund manager, who is a finance professional, manages the pooled investment. The fund manager purchases securities such as stocks and bonds that are in line with the investment mandate.

Mutual funds are an excellent investment option for individual investors to get exposure to an expert managed portfolio. Also, you can diversify your portfolio by investing in mutual funds as the asset allocationwould cover several instruments. Investors would be allocated with fund units based on the amount they invest. Each investor would hence experience profits or losses that are directly proportional to the amount they invest. The main intention of the fund manager is to provide optimum returns to investors by investing in securities that are in sync with the fund's objectives. The performanceof mutual funds is dependent on the underlying assets.

Types of Mutual Funds

Mutual funds in India are broadly classified into equity funds, debt funds, and balanced mutual funds, depending on their asset allocation and equity exposure. Therefore, the risk assumed and returns provided by a mutual fund plan would depend on its type. We have broken down the types of Mutual fundsin detail below:

1. Equity funds, as the name suggests, invest mostly in equity shares of companies across all market capitalisations. A mutual fund is categorised under equity fund if it invests at least 65% of its portfolio in equity instruments. Equity funds have the potential to offer the highest returns among all classes of mutual funds. The returns provided by equity funds depend on the market movements, which are influenced by several geopolitical and economic factors. The equity funds are further classified as below:

   i. **Small-Cap Funds**

Small-cap funds are those equity funds that predominantly invest in equity and equity-linked instruments of companies with small market capitalisation. SEBI defines small-cap companies as those that are ranked after 251 in market capitalisation.

ii. Mid-Cap Funds

Mid-cap funds are those equity funds that invest primarily in equity and equity-linked instruments of companies with medium market capitalisation. SEBI defines mid-cap companies as those that are ranked between 101 and 250 in market capitalisation.

iii. Large-Cap Funds

Large-cap funds are those equity funds that invest mostly in equity and equity-linked instruments of companies with large market capitalisation. SEBI defines large-cap companies as those that are ranked between 1 and 100 in market capitalisation.

iv. Multi-Cap Funds

Multi-Cap Funds invest substantially in equity and equity-linked instruments of companies across all market capitalisations. The fund manager would change the asset allocation depending on the market condition to reap the maximum returns for investors and reduce the risk levels.

v. Sector or Thematic Funds

Sectoral funds invest principally in equity and equity-linked instruments of companies in a particular sector like FMCG and IT. Thematic funds invest in equities of companies that operate with a similar theme like travel.

vi. Index Funds

Index Funds are a type of equity funds having the intention of tracking and emulating the performance of a popular stock market index such as the S&P BSE Sensex and NSE Nifty50. The asset allocation of an index fund would be the same as that of its underlying index. Therefore, the returns offered by index mutual funds would be similar to that of its underlying index.

vii. ELSS

Equity-Linked Savings Scheme(ELSS) is the only kind of mutual funds covered under Section 80Cof the Income Tax Act, 1961. Investors can claim tax deductions of up to Rs 1,50,000 a year by investing in ELSS.

2. Debt Mutual Funds

Debt mutual funds invest mostly in debt, money market and other fixed-income instruments such as treasury bills, government bonds, certificates of deposit, and other high-rated securities. A mutual fund is considered a debt fund if it invests a minimum of 65% of its portfolio in debt securities. Debt funds are ideal for risk-averse investors as the performance of debt funds is not influenced much by the market fluctuations. Therefore, the returns provided by debt funds are very much predictable. The debt funds are further classified as below:

i. Dynamic Bond Funds

Dynamic Bond Funds are those debt funds whose portfolio is modified depending on the fluctuations in the interest rates.

ii. Income Funds

Income Funds invest in securities that come with a long maturity period and therefore, provide stable returns over time. The average maturity period of these funds is five years.

iii. Short-Term and Ultra Short-Term Debt Funds

Short-term and ultra short-term debt funds are those mutual funds that invest in securities that mature in one to three years. These funds are ideal for risk-averse investors.

iv. Liquid Funds

Liquid funds are debt funds that invest in assets and securities that mature within ninety-one days. These mutual funds generally invest in high-rated instruments. Liquid funds are a great option to park your surplus funds, and they offer higher returns than a regular savings bank account.

v. Gilt Funds

Gilt Funds are debt funds that invest in high-rated government securities. It is for this reason that these funds possess lower levels of risk and are apt for risk-averse investors.

vi. Credit Opportunities Funds

Credit Opportunities Funds mostly invest in low rated securities that have the potential to provide higher returns. Naturally, these funds are the riskiest class of debt funds.

vii. Fixed Maturity Plans

Fixed maturity plans (FMPs) are close-ended debt funds that invest in fixed income securities such as government bonds. You may invest in FMPs only during the fund offer period, and the investment will be locked-in for a predefined period.

3. Balanced or Hybrid Mutual Funds

Balanced or hybrid mutual funds invest across both equity and debt instruments. The main objective of hybrid funds is to balance the risk-reward ratio by diversifying the portfolio. The fund manager would modify the asset allocation of the fund depending on the market condition, to benefit the investors and reduce the risk levels. Investing in hybrid funds is an excellent way of diversifying your portfolio as you would gain exposure to both equity and debt instruments. The debt funds are further classified as below:

i. **Equity-Oriented Hybrid Funds**

Equity-oriented hybrid funds are those that invest at least 65% of its portfolio in equities while the rest is invested in fixed-income instruments.

ii. **Debt-Oriented Hybrid Funds**

Debt-oriented hybrid funds allocate at least 65% of its portfolio in fixed-income instruments such as treasury bills and government securities, and the rest is invested in equities.

iii. **Monthly Income Plans**

Monthly income plans (MIPs) majorly invest in debt instruments and aim at providing a steady return over time. The equity exposure is usually limited to under 20%. You can decide if you would receive dividends on a monthly, quarterly, or annual basis.

iv. **Arbitrage Funds**

Arbitrage funds aim at maximising the returns by purchasing securities in one market at lower prices and selling them in another market at a premium. However, if the arbitrage opportunities are not available, then the fund manager may choose to invest in debt securities or cash equivalents.

RISK INVOLVED

Types of risks associated with mutual funds

a. Market Risk

We all would have seen that one-liner in all advertisements that mutual funds are subject to market risk.

Market risk is a risk which may result in losses for any investor due to the poor performance of the market. There are a lot of factors that affect the market. A few examples are a natural disaster, inflation, recession, political unrest, fluctuation of interest rates, and so on. Market risk is also known as systematic risk. Diversifying a person’s portfolio won’t help in these scenarios. The only thing that an investor can do is to wait for the things to fall in place.

b. Concentration Risk

Concentration generally means focusing on just one thing. Concentrating a considerable amount of a person's investment in one particular scheme is never a good option. Profits will be huge if lucky, but the losses will be pronounced at times. The best way to minimise this risk is by diversifying your portfolio. Concentrating and investing heavily in one sector is also risky. The more diverse the portfolio, the lesser the risk is.

c. Interest Rate Risk

Interest rate changes depending on the credit available with lenders and the demand from borrowers. They are inversely related to each other. Increase in the interest rates during the investment period may result in a reduction of the price of securities.
For example, an individual decides to invest Rs.100 with a rate of 5% for a period of x years. If the interest rate changes for some reason and it becomes 6%, the individual will no longer be able to get back the Rs.100 he invested because the rate is fixed. The only option here is reducing the market value of the bond. If the interest rate reduces to 4% on the other hand, the investor can sell it at a price above the invested amount.

d. Liquidity Risk

Liquidity risk refers to the difficulty to redeem an investment without incurring a loss in the value of the instrument. It can also occur when a seller is unable to find a buyer for the security. In mutual funds, like ELSS, the lock-in period may result in liquidity risk. Nothing can be done during the lock-in period. In yet another case, exchange-traded funds (ETFs) might suffer from liquidity risk. As you may know, ETFs can be bought and sold on the stock exchanges like shares. Sometimes due to lack of buyers in the market, you might be unable to redeem your investments when you need them the most. The best way to avoid this is to have a very diverse portfolio and to select the fund diligently.

e. Credit Risk

Credit risk means that the issuer of the scheme is unable to pay what was promised as interest. Usually, agencies which handle investments are rated by rating agencieson these criteria. So, a person will always see that a firm with a high rating will pay less and vice-versa. Mutual Funds, particularly debt funds, also suffer from credit risk. In debt funds, the fund manager has to incorporate only investment-grade securities. But sometimes it might happen that to earn higher returns, the fund manager may include lower credit-rated securities. This would increase the credit risk of the portfolio. Before investing in a debt fund, have a look at the credit ratings of the portfolio composition.

5.5 SEBI REGULATIONS FOR MUTUAL FUNDS

Important steps taken by SEBI for the regulation of mutual funds are listed below:

(1) Formation:

Certain structural changes have also been made in the mutual fund industry, as part of which mutual funds are required to set up asset management companies with fifty percent independent directors, separate board of trustee companies, consisting of a minimum fifty percent of independent trustees and to appoint independent custodians.

This is to ensure an arm's length relationship between trustees, fund managers and custodians, and is in contrast with the situation prevailing earlier in which all three functions were often performed by one body which was usually the sponsor of the fund or a subsidiary of the sponsor.

Thus, the process of forming and floating mutual funds has been made a tripartite exercise by authorities. The trustees, the asset management companies (AMCs) and the mutual fund shareholders form the three legs. SEBI guidelines provide for the trustees to maintain an arm's length relationship with the AMCs and do all those things that would secure the right of investors.

With funds being managed by AMCs and custody of assets remaining with trustees, an element of counter-balancing of risks exists as both can keep tabs on each other.

(2) Registration:

In January 1993, SEBI prescribed registration of mutual funds taking into account track record of a sponsor, integrity in business transactions and financial soundness while granting permission.

This will curb excessive growth of the mutual funds and protect investor's interest by registering only the sound promoters with a proven track record and financial strength. In February 1993, SEBI cleared six private sector mutual funds viz. 20th Century Finance Corporation, Industrial Credit & Investment Corporation of India, Tata Sons, Credit Capital Finance Corporation, Ceat Financial Services and Apple Industries.

(3) Documents:

The offer documents of schemes launched by mutual funds and the scheme particulars are required to be vetted by SEBI. A standard format for mutual fund prospectuses is being formulated.

(4) Code of advertisement:

Mutual funds have been required to adhere to a code of advertisement.

(5) Assurance on returns:

SEBI has introduced a change in the Securities Control and Regulations Act governing the mutual funds. Now the mutual funds were prevented from giving any assurance on the land of returns they would be providing. However, under pressure from the mutual funds, SEBI revised the guidelines allowing assurances on return subject to certain conditions.

Hence, only those mutual funds which have been in the market for at least five years are allowed to assure a maximum return of 12 per cent only, for one year. With this, SEBI, by default, allowed public sector mutual funds an advantage against the newly set up private mutual funds.

As per basic tenets of investment, it can be justifiably argued that investments in the capital market carried a certain amount of risk, and any investor investing in the markets with an aim of making profit from capital appreciation, or otherwise, should also be prepared to bear the risks of loss.

(6) Minimum corpus:

The current SEBI guidelines on mutual funds prescribe a minimum start-up corpus of Rs.50 crore for a open-ended scheme, and Rs.20 crore corpus for closed-ended scheme, failing which application money has to be refunded.

The idea behind forwarding such a proposal to SEBI is that in the past, the minimum corpus requirements have forced AMCs to solicit funds from corporate bodies, thus reducing mutual funds into quasi-portfolio management outfits. In fact, the Association of Mutual Funds in India (AMFI) has repeatedly appealed to the regulatory authorities for scrapping the minimum corpus requirements.

(7) Institutionalisation:

The efforts of SEBI have, in the last few years, been to institutionalise the market by introducing proportionate allotment and increasing the minimum deposit amount to Rs.5000 etc. These efforts are to channel the investment of individual investors into the mutual funds.

(8) Investment of funds mobilised:

In November 1992, SEBI increased the time limit from six months to nine months within which the mutual funds have to invest resources raised from the latest tax saving schemes. The guideline was issued to protect the mutual funds from the disadvantage of investing funds in the bullish market at very high prices and suffering from poor NAV thereafter.

(9) Investment in money market:

SEBI guidelines say that mutual funds can invest a maximum of 25 per cent of resources mobilised into money-market instruments in the first six months after closing the funds and a maximum of 15 per cent of the corpus after six months to meet short term liquidity requirements.

Private sector mutual funds, for the first time, were allowed to invest in the call money market after this year’s budget. However, as SEBI regulations limit their exposure to money markets, mutual funds are not major players in the call money market. Thus, mutual funds do not have a significant impact on the call money market.

(10) Valuation of investment:

The transparent and well understood declaration or Net Asset Values (NAVs) of mutual fund schemes is an important issue in providing investors with information as to the performance of the fund. SEBI has warned some mutual funds earlier of unhealthy market

(11) Inspection:

SEBI inspect mutual funds every year. A full SEBI inspection of all the 27 mutual funds was proposed to be done by the March 1996 to streamline their operations and protect the investor's interests. Mutual funds are monitored and inspected by SEBI to ensure compliance with the regulations.

(12) Underwriting:

In July 1994, SEBI permitted mutual funds to take up underwriting of primary issues as a part of their investment activity. This step may assist the mutual funds in diversifying their business.

(13) Conduct:

In September 1994, it was clarified by SEBI that mutual funds shall not offer buy back schemes or assured returns to corporate investors. The Regulations governing Mutual Funds and Portfolio Managers ensure transparency in their functioning.

(14) Voting rights:

In September 1993, mutual funds were allowed to exercise their voting rights. Department of Company Affairs has reportedly granted mutual funds the right to vote as full-fledged shareholders in companies where they have equity investments.

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