Q1)a)Match the Following(Any 8) (08)

a) Securities and Exchange Board of India
b) Global Depository Receipts
c) American Depository Receipts
d) International Organization of Securities Commissions
e) No voting rights
f) Voting rights
g) Collective Investment Management Company
h) Exchange traded funds
i) Units
j) Short term

b)True or False(Any 7) (07)

a) True
b) True
c) False
d) True
e) False
f) False
g) True
h) True
i) False
j) False

Q2)a) Profile of Securities Market (08)

Classification of Financial Markets in India According to the period of maturity of the

financial assets with which the markets are dealing, the markets can be classified as

(a) Money Market

(b) Capital Market. Chart

(a) Money Market Money market deals in short-term debt and channels the savings into

shortterm productive investments like working capital, call money, treasury bills etc. The

money market is a component of the financial markets for assets involved in shortterm

borrowing and lending with original maturities of one year or shorter time frames. It provides

liquidity funding for the global financial system. Treasury Bills (T-Bills), Certificate of

Deposit, Repurchase Agreements, Banker's Acceptance, Commercial Papers are the popular

instruments of the money market.

(b) Capital Market Capital market is the market for financial assets having a period of

maturity of more than one year or of an indefinite period. Thus, capital market provides long-

term resources needed by medium and large scale industries. According to Khan and Jain

(2011)3 , “The capital market is created by a financial relationship created by a number of

institutions and arrangement that allows suppliers and demands of long-term funds (i.e. funds

with maturities exceeding one year) to make transactions. It is a market for long term funds.

(c) “The primary market provides a direct link between the prospective investors and the

company. By providing liquidity and safety, the stock markets encourage the public to

subscribe to the new issues. “The primary market provides a direct link between the

prospective investors and the company. By providing liquidity and safety, the stock markets

encourage the public to subscribe to the new issues. The Indian Capital Market attracts the

investing public towards the stock market. Thus, it provides an indirect link between the

savers and the company. ” This is the market for new long term equity capital. The primary

market is the market where the securities are sold for the first time. Therefore it is also called

the New Issue Market (NIM). The NIM has neither any tangible form any administrative

organisational set up like that of stock exchanges, nor is it subjected to any centralised control

and administration for the achievement of the ultimate goal of its business.”

(d) Secondary Market The secondary market, also called aftermarket, is the financial market

where previously issued securities and financial instruments such as stock, bonds, options,

and futures are bought and sold. Another frequent usage of "secondary market" is to refer to

loans which are sold by a mortgage bank to investors. The term ‘secondary market’ is also

used to refer to the market for any used goods or assets, or an alternative use for an existing

product or asset where the customer base is the second market. It is for a variety of assets can

vary from loans to stocks, from fragmented to centralized, and from illiquid to very liquid.

The major stock exchanges are the most visible example of liquid secondary markets - in this

case, for stocks of publicly traded companies.

• Stock Exchange A stock exchange is an entity that provides services for stock brokers and

traders to trade stocks, bonds, and other securities. Stock exchanges also provide facilities for

issue and redemption of securities and other financial instruments, and capital events

including the payment of income and dividends. Securities traded on a stock exchange

include

b) SEBI and the Capital Market Reforms in India (07)

The following points highlight the top four steps taken by SEBI to strengthen the capital market reforms. The steps are:

Step # 1. Primary Market Reforms:

SEBI has introduced various guidelines and regulatory measures to improve conditions of capital issues. As per these measures companies issuing capital in the primary market are now required to disclose and clarify all material facts and specific risk factors, if any, related to their projects along with the basic information related to calculation of premium.

In order to ensure fair and truthful disclosures, SEBI has also introduced code of advertisement for public issues. SEBI has made the underwriting of issue optional so as to reduce the cost of issue. SEBI has also enhanced the minimum application size along with the proportion of each issue allowed for firm allotment to institutions such as mutual funds.

SEBI has again introduced shares and takeovers and also frame conditions under which disclosures and mandatory public offers are to be made to the shareholders.

SEBI has also brought merchant banking statutorily under its regulatory framework. Now the merchant bankers are to be authorised by SEBI and to adopt stipulatory capital adequacy norms and also abide by the code of conduct. Under

the present framework, merchant bankers are having greater degree of accountability in the documentation of offer and its issue process.

In order to protect the interest of investors, the

In case of non-compliance of the provisions related to listing agreement, non-despatch of refund orders, share certificates etc. by registered post within the stipulated time frame, the company is going to forfeit such one per cent deposit.

In order to cross check the difference between the promises and performances of the companies, the SEBI has advised stock exchanges to amend the listing agreement and make it obligatory on the part of listed company to furnish annual statement to the SEs showing variations if any, between financial projections, projected utilisation of fund and its actual utilisation.

Setting up of private mutual funds are now being permitted by the Government and a few have been set up. The mutual funds are now permitted to underwrite public issues in order to improve the scope of its investment. SEBI has also relaxed the guidelines for making investment in the money market instruments. Moreover, SEBI has also issued fresh guidelines for making advertisement by mutual funds.

In order to ensure that all disclosures have been clearly made by the company in its offer documents, SEBI checks this documents carefully as a routine job. Various guidelines and regulatory measures of capital issues are incorporated by the SEBI to promote healthy and efficient functioning of the primary market.

Even after the introduction of all these measures, there are many instances of break of issue procedures in collusion with the unscrupulous promoters and corrupt officials of the lead banks and also with the top officials of SEBI as it was found in case of mega-issue of M.S. Shoes East Ltd. in March, 1995.

Step # 2. Global Depository Receipts (GDRs):

The Government of India permitted Indian companies to have access in the international capital markets through Euro equity shares since 1992. In the initial period, the Government allowed the utilisation of Euro issue proceeds for approved end uses.

Later on, with the accumulation of foreign exchange reserves with RBI, the issuing companies were allowed to retain the Euro-issue proceeds abroad and repatriate them in times of need.

Till January 1995, Indian Companies have been able to raise US $ 3.6 billion through launching of GDR issues and US $ 1.1 billion through launching of Euro Convertible Bonds (ECBs).

Moreover, the Government of India has also liberalised investment norms for the NRIs sufficiently which has enabled the NRIs and overseas corporate bodies to buy shares and debentures without prior permission from the Reserve Bank of India.

Step # 3. Secondary Market Reforms:

SEBI has introduced secondary market reforms and as a part of its reforms, it has started the process of registration of intermediaries like stock brokers and sub-

brokers under the provisions of the Securities and Stock Exchange Board Act, 1992.

Here the registration in done on the basis of certain eligibility norms viz., capital adequacy, transparency infrastructure etc. SEBI has also introduced rules so as to make the way for client/broker relationship more transparent and to segregate client and broker accounts.

In order to protect and preserve the integrity of stock markets, the SEBI has introduced certain regulations under the provisions of SEBI Act, which, in turn, would help inspire confidence of the investor in the stock exchanges. In-spite of this, insider trading, rigging of the market and manipulating stock market price quotations are still continuing.

The traditional trading system of Indian SEs has been constantly reviewed by SEBI since 1992. SEBI is instrumental in simplifying procedures, attaining transparency in costs and prices of stocks, speeding up clearing and settlement and transferring shares in the name of buyers. SEBI has prohibited completely the “renewal” of transactions in “B” group securities so as to settle the transactions within 7 days.

SEBI has also issued guidelines for the composition of Governing Body (GB) of stock exchange so as to make it more broad-based. Moreover, SEBI had successfully reconstituted the GBs of stock exchanges in 1994-95.

Government has also permitted the foreign institutional investors (FIIs) like mutual funds, pension funds, investment trusts, asset or portfolio management companies etc. to invest their capital in Indian capital market as and when they

are registered with SEBI. Total number of FIIs, registered with SEBI, which was only 10 in January 1993 and 136 in January 1994 has substantially increased to 286 in January 1995.

Besides, the cumulative net investments of FIIs has considerably increased from $ 200 million in January 1993 to $ 3 billion in January 1995, which reflects the growing impact of liberalisation policy of the country.

Step # 4. Capital Market Reforms, 1996-97:

An array of capital market reforms were introduced during 1996- 97, encompassing primary and secondary markets, equity and debt, and foreign institutional investment. Primary market reforms aimed at imparting greater flexibility in the issue process and strengthening the criteria for accessing the securities market.

Reforms in the secondary market aimed at improving market transparency, integrity and trading infrastructure.

Among the reforms which were undertaken are given below:

1. Passing of the Depositories Act, 1996 by Parliament, providing a legal framework for recording ownership details in book-entry form and facilitating dematerialization of securities. The Depositories Related Laws (Am6ndment), 1997 issued through an Ordinance, which allowed banks; mutual funds and IDBI to dematerialize their scripts.

2. Formulation of SEBI (Depositories and Participants) Regulations, 1996, which allowed SEBI to regulate establishment and functioning of depositories, and to protect investor interests.

3. Tightening of entry norms for equity issue by companies, to improve quality.

4. Giving up vetting of public issue offer documents by SEBI, to encourage self regulation. SEBI, comments, (if any) to be sent within 21 days of filing.

5. Debt issues not accompanied by an equity component permitted to be sold entirely by the Book- Building process.

6. Issuers allowed to list debt securities on stock exchanges even if equity is not listed.

7. FIIs permitted to invest up to 10 per cent in the equity of any company, to invest in unlisted companies, to set up pure (100 per cent) debt funds, and to invest in government securities.

8. Eligibility criteria for registration an FII were modified to allow endowment funds, university funds, foundations and charitable trusts/societies to register.

9. Stock lending scheme was introduced and this will not attract capital gains.

10. The SEBI (Mutual Funds) Regulations, 1993 were revised to provide for portfolio disclosure, standardisation of accounting policies, valuation norms for determining net asset value and pricing.

11. SEBI regulations on Venture Capital Funds (VCF) were issued, allowing them to invest in unlisted companies, to finance turnaround companies, and to provide loans. These provide flexibility to VCFs so that high risk finance can be provided to the market.

12. Modified takeover code, based on the recommendations of the Bhagwati Committee, was approved. It requires a mandatory minimum public offer of 20 per cent purchase, when the threshold limit of 10 per cent equity holding is crossed. Those in "control" are permitted to purchase 2 per cent of shares per annum up to 51 per cent.
To discourage frivolous attempts, acquirers will have to deposit a certain value of cash and assets in an escrow account. The escrow deposit would be higher for conditional public offers, unless the acquirer agrees to acquire a minimum of 20 per cent.

13. SEBI approved almost all the recommendations of the Dave Committee for improving the working of the Over the Counter

OR

C) Capital Market Reforms to boost Investor Confidence: (08)

1.Control over Issue of Capital: Capital issues Control Act was established which asked the

issuers to issue securities at a particular rate if they are under the eligibility criteria.

2.Establishment of Regulator:SEBI was established as a regulatory body of Capital Market.

3.Screen Based Trading:A world wide online trading system was established where the

investors can punch in for the required quantities of shares and sell it to the counter party

required.

4.Settlement Guarantee: Clearing corporations was established which reduced the time for

settlement of transactions.

5.Securities Market Awareness.SEBI initiated the measures to educate the investors

regarding the rules and regulations of capital market which made the investors to trade in the

capital market undoubtedly.

International Organization of Securities Commissions

The International Organisation of Securities Commissions (IOSCO) is an association of

organisations that regulate the world's securities and futures markets. Members are typically

primary securities and/or futures regulators in a national jurisdiction or the main financial

regulator from each country. Its mandate is to:[2]

 Develop, implement, and promote high standards of regulation to enhance investor

protection and reduce systemic risk

 Share information with exchanges and assist them with technical and operational

issues

 Establish standards toward monitoring global investment transactions across borders

and markets

d) The capital market, as it is known, is that segment of the financial market that deals with

the effective channeling of medium to long-term funds from the surplus to the deficit

unit. The process of transfer of funds is done through instruments, which are documents (or

certificates), showing evidence of investments. The instruments traded (media of exchange)

in the capital market are:

1.Debt Instruments

A debt instrument is used by either companies or governments to generate funds for capital-

intensive projects. It can obtained either through the primary or secondary market. The

relationship in this form of instrument ownership is that of a borrower – creditor and thus,

does not necessarily imply ownership in the business of the borrower. The contract is for a

specific duration and interest is paid at specified periods as stated in the trust deed* (contract

agreement). The principal sum invested, is therefore repaid at the expiration of the contract

period with interest either paid quarterly, semi-annually or annually. The interest stated in the

trust deed may be either fixed or flexible. The tenure of this category ranges from 3 to 25

years. Investment in this instrument is, most times, risk-free and therefore yields lower

returns when compared to other instruments traded in the capital market.

2. Equities (also called Common Stock)

This instrument is issued by companies only and can also be obtained either in the primary

market or the secondary market. Investment in this form of business translates to ownership

of the business as the contract stands in perpetuity unless sold to another investor in the

secondary market. The investor therefore possesses certain rights and privileges (such as to

vote and hold position) in the company. Whereas the investor in debts may be entitled to

interest which must be paid, the equity holder receives dividends which may or may not be

declared.

The risk factor in this instrument is high and thus yields a higher return (when

successful). Holders of this instrument however rank bottom on the scale of preference in the

event of liquidation of a company as they are considered owners of the company.

3.Preference Shares

This instrument is issued by corporate bodies and the investors rank second (after bond

holders) on the scale of preference when a company goes under. The instrument possesses the

characteristics of equity in the sense that when the authorised share capital and paid up

capital are being calculated, they are added to equity capital to arrive at the total. Preference

shares can also be treated as a debt instrument as they do not confer voting rights on its

holders and have a dividend payment that is structured like interest (coupon) paid for bonds

issues.

Preference shares may be:

 Irredeemable, convertible: in this case, upon maturity of the instrument, the principal

sum being returned to the investor is converted to equities even though dividends

(interest) had earlier been paid.

 Irredeemable, non-convertible: here, the holder can only sell his holding in the

secondary market as the contract will always be rolled over upon maturity. The

instrument will also not be converted to equities.

 Redeemable: here the principal sum is repaid at the end of a specified period. In this

case it is treated strictly as a debt instrument.

Note: interest may be cumulative, flexible or fixed depending on the agreement in the Trust

Deed.

4. Derivatives

These are instruments that derive from other securities, which are referred to as underlying

assets (as the derivative is derived from them). The price, riskiness and function of the

derivative depend on the underlying assets since whatever affects the underlying asset must

affect the derivative. The derivative might be an asset, index or even situation. Derivatives

are mostly common in developed economies.

Some examples of derivatives are:

- Mortgage-Backed Securities (MBS)
- Asset-Backed Securities (ABS)
- Futures
- Options
- Swaps
- Rights
- Exchange Traded Funds or commodities

Of all the above stated derivatives, the common one in Nigeria is Rights where by the holder

of an existing security gets the opportunity to acquire additional quantity to his holding in an

allocated ratio.

Q3a) Functions and Significance of StockExchanges.

Some of the Important Functions of Stock Exchange/Secondary Market are listed below:

1. Economic Barometer:

A stock exchange is a reliable barometer to measure the economic condition of a country.

Every major change in country and economy is reflected in the prices of shares. The rise or fall in the share prices indicates the boom or recession cycle of the economy. Stock exchange is also known as a pulse of economy or economic mirror which reflects the economic conditions of a country.

2. Pricing of Securities:

The stock market helps to value the securities on the basis of demand and supply factors. The securities of profitable and growth oriented companies are valued higher as there is more demand for such securities. The valuation of securities is useful for investors, government and creditors. The investors can know the value of their investment, the creditors can value the creditworthiness and government can impose taxes on value of securities.

3. Safety of Transactions:

In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company. The companies which are listed they also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.

4. Contributes to Economic Growth:

In stock exchange securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

5. Spreading of Equity Cult:

Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

6. Providing Scope for Speculation:

To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

7. Liquidity:

The main function of stock market is to provide ready market for sale and purchase of securities. The presence of stock exchange market gives assurance to investors that their investment can be converted into cash whenever they want. The investors can invest in long term investment projects without any hesitation, as because of stock exchange they can convert long term investment into short term and medium term.

8. Better Allocation of Capital:

The shares of profit making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market. The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor's fund to profitable channels.

9. Promotes the Habits of Savings and Investment:

The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc.

b) Trading Mechanism

Trading at both the exchanges takes place through an open electronic limit order book, in which order matching is done by the trading computer. There are no market makers or specialists and the entire process is order-driven, which means that market orders placed by investors are automatically matched with the best limit orders. As a result, buyers and sellers remain anonymous. The advantage of an order driven market is that it brings more transparency, by displaying all buy and sell orders in the trading system. However, in the absence of market makers, there is no guarantee that orders will be executed.

All orders in the trading system need to be placed through brokers, many of which provide online trading facility to retail customers. Institutional investors can also take advantage of the direct market access (DMA) option, in which they use trading terminals provided by brokers for placing orders directly into the stock market trading system.

Settlement Cycle and Trading Hours

Equity spot markets follow a T+2 rolling settlement. This means that any trade taking place on Monday, gets settled by Wednesday. All trading on stock exchanges takes place between 9:55 am and 3:30 pm, Indian Standard Time (+ 5.5 hours GMT), Monday through Friday. Delivery of shares must be made in dematerialized form, and each exchange has its own clearing house, which assumes all settlement risk, by serving as a central counterparty.

Market Indexes

The two prominent Indian market indexes are Sensex and Nifty. Sensex is the oldest market index for equities; it includes shares of 30 firms listed on the BSE, which represent about 45% of the index's free-float market capitalization. It was created in 1986 and provides time series data from April 1979, onward.

Another index is the S&P CNX Nifty; it includes 50 shares listed on the NSE, which represent about 62% of its free-float market capitalization. It was created in 1996 and provides time series data from July 1990, onward. (

Market Regulation

The overall responsibility of development, regulation and supervision of te stock market rests with the Securities & Exchange Board of India (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach.

India started permitting outside investments only in the 1990s. Foreign investments are classified into two categories: foreign direct investment (FDI) and foreign portfolio investment (FPI). All investments in which an investor takes part in the day-to-day management and operations of the company, are treated as FDI, whereas investments in shares without any control over management and operations, are treated as FPI.

For making portfolio investment in India, one should be registered either as a foreign institutional investor (FII) or as one of the sub-accounts of one of the registered FIIs. Both registrations are granted by the market regulator, SEBI.

Foreign institutional investors mainly consist of mutual funds, pension funds, endowments, sovereign wealth funds, insurance companies, banks, asset management companies etc. At present, India does not allow foreign individuals

to invest directly into its stock market. However, high-net-worth individuals (those with a net worth of at least $US50 million) can be registered as sub-accounts of an FII.

Foreign institutional investors and their sub accounts can invest directly into any of the stocks listed on any of the stock exchanges. Most portfolio investments consist of investment in securities in the primary and secondary markets, including shares, debentures and warrants of companies listed or to be listed on a recognized stock exchange in India. FIIs can also invest in unlisted securitiesoutside stock exchanges, subject to approval of the price by the Reserve Bank of India. Finally, they can invest in units of mutual funds and derivatives traded on any stock exchange.

An FII registered as a debt-only FII can invest 100% of its investment into debt instruments. Other FIIs must invest a minimum of 70% of their investments in equity. The balance of 30% can be invested in debt. FIIs must use special non-resident rupee bank accounts, in order to move money in and out of India. The balances held in such an account can be fully repatriated.

Restrictions/Investment Ceilings

The government of India prescribes the FDI limit and different ceilings have been prescribed for different sectors. Over a period of time, the government has been progressively increasing the ceilings. FDI ceilings mostly fall in the range of 26-100%.

By default, the maximum limit for portfolio investment in a particular listed firm, is decided by the FDI limit prescribed for the sector to which the firm belongs. However, there are two additional restrictions on portfolio investment. First, the

aggregate limit of investment by all FIIs, inclusive of their sub-accounts in any particular firm, has been fixed at 24% of the paid-up capital. However, the same can be raised up to the sector cap, with the approval of the company's boards and shareholders.

Secondly, investment by any single FII in any particular firm should not exceed 10% of the paid-up capital of the company. Regulations permit a separate 10% ceiling on investment for each of the sub-accounts of an FII, in any particular firm. However, in case of foreign corporations or individuals investing as a sub-account, the same ceiling is only 5%. Regulations also impose limits for investment in equity-based derivatives trading on stock exchanges

OR

c) Margin and Margin Trading (08)

Margin trading refers to the practice of using borrowed funds from a broker to trade a financial asset, which forms the collateral for the loan from the broker. Since such use of financial leverage can potentially magnify gains but could also saddle the trader with devastating losses, leverage has the well-deserved reputation of being a double-edged sword.

Because of the heightened risks of margin trading, it can only be conducted in a type of account known as a margin account, which differs from the regular cash account used by most investors. While stocks can be purchased either in cash or margin accounts, short sales can only be made in margin accounts; as well, certain instruments like commodities and futures can only be traded in margin accounts.

Margin refers to the amount of funds that the trader or investor must personally put up from his or her own resources, and can vary widely depending on the asset

or instrument. For instance, currency futures typically need a margin that amounts to a low single-digit percentage of the currency contract’s value. A stock bought on margin generally requires the investor to supply 30% to 50% of the value of the purchase transaction. As a rule of thumb, the greater the volatility of the stock, the higher will be the margin requirement.

d) Securities Lending and Borrowing (07)

Securities lending and borrowing (SLB)is a system in which traders borrow shares that they do not already own, or lend the stocks that they own but do not intend to sell immediately.

Just like in a loan, SLB transaction happens at a rate of interest and tenure that is fixed by the two parties entering the transaction. However, there are some differences – crucially, the rate of interest is market-determined and free of control. Only stocks in the futures and option segment can be borrowed and lent.

The interest rate in a stock lending and borrowing transaction is dependent on the stock’s value on that day. Most commonly, rates are calculated on a per-month basis.
Stocks borrowed can be of any tenure up to 12 months. Each SLB transaction is marked with the month in which is due to be settled. The first Thursday of each month is the settlement data for returning the shares to the lender.

The tenure is however not strict, and the lender of stocks has the right to recall the shares at any point during the tenure.

The main function of borrowed stocks is to short-sell them in the market. When a trader has a negative view on a stock price, then s/he can borrow shares from SLB, sell them, and buy them back when the price falls.

The difference between the selling and buying price, minus the interest rate (and other costs) is the trader's profits.

Stocks are lent by long-term investors like HNIs who own large number of shares that they do not intend to sell in the near future.

Q4)a) American depository receipt (08)

An American depositary receipt is a negotiable security that represents securities of a non-U.S. company that trades in the U.S. financial markets.
Shares of many non-U.S. companies trade on U.S. stock exchanges through ADRs, which are denominated and pay dividends in U.S. dollars and may be traded like regular shares of stock.ADRs are also traded during U.S. trading hours, through U.S. broker-dealers. ADRs simplify investing in foreign securities by having the depositary bank "manage all custody, currency and local taxes issues".
Global Depository Receipts

A global depository receipt is a general name for a depository receipt where a certificate issued by a depository bank, which purchases shares of foreign companies, creates a security on a local exchange backed by those shares. They

are the global equivalent of the original American depository receipts (ADR) on which they are based. GDRs represent ownership of an underlying number of shares of a foreign company and are commonly used to invest in companies from developing or emerging markets by investors in developed markets.

b) FCCB vs FCEB (07)

Foreign currency convertible bonds (FCCBs) are issued by a company to non-residents giving them the option to convert them into shares of the same company at a predetermined price. On the other hand, foreign currency exchangeable bonds are issued by the investment or holding company of a group to non-residents which are exchangeable for the shares of the specified group company at a predetermined price.

The key difference, therefore, is while FCCB involves just one company, FCEB involves at least two companies — the bonds are usually of the parent company while the shares are of the operating company which must be a listed company.

Issue of Foreign Currency Exchangeable Bonds (FCEB) Scheme, 2008
In financial year 2007-08, the Indian Government notified the Foreign Currency Exchangeable Bonds Scheme, 2008 for the issue of FCEBs. The provisions of the scheme is as under:

OR

C) External commercial borrowings: forms and features (15)

Meaning: –

External Commercial Borrowings (ECB) refer to commercial loans in the form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares) availed of from non-resident lenders with a minimum average maturity of 3 years.

Types of routes

ECB can be accessed under two routes, viz.,

(i) Automatic Route outlined in paragraph I (A)

(ii) Approval Route

(A) Automatic route

The following types of proposals for ECBs are covered under the Automatic Route.

i) Eligible Borrowers

(a) Corporates, including those in the hotel, hospital, software sectors(registered under the Companies Act, 1956), Non-Banking Finance Companies (NBFCs) – Infrastructure Finance Companies (IFCs), NBFCs – Asset Finance companies (AFCs), Small Industries Development Bank of India (SIDBI) except financial intermediaries, such as banks, financial institutions (FIs), Housing Finance Companies (HFCs) and Non-Banking Financial Companies (NBFCs), other than those specifically allowed by Reserve Bank, are eligible to raise ECB. Individuals, Trusts (other than those engaged in Micro-finance activities) and Non-Profit making organizations are not eligible to raise ECB.

(b) Units in Special Economic Zones (SEZ) are allowed to raise ECB for their own requirement. However, they cannot transfer or on-lend ECB funds to sister concerns or any unit in the Domestic Tariff Area (DTA).

(c) NBFCs-IFCs are permitted to avail of ECBs for on-lending to the infrastructure sector as defined under the ECB policy

(d) NBFCs-AFCs are permitted to avail of ECBs for financing the import of infrastructure equipment for leasing to infrastructure projects

(e) Non-Government Organizations (NGOs) engaged in micro finance activities are eligible to avail of ECB.

(f) Micro Finance Institutions (MFIs) engaged in micro finance activities are eligible to avail of ECBs. MFIs registered under the Societies Registration Act, 1860, MFIs registered under Indian Trust Act, 1882, MFIs registered either under the conventional state-level cooperative acts, the national level multi-state cooperative legislation or under the new state-level mutually aided cooperative acts (MACS Act) and not being a co-operative bank, Non-Banking Financial Companies (NBFCs) categorized as 'Non Banking Financial Company-Micro Finance Institutions' (NBFCMFIs) and complying with the norms prescribed as per circular DNBS.CC.PD.No. 250/03.10.01/2011-12 dated December 02, 2011 and Companies registered under Section 25 of the Companies Act, 1956 and are involved in micro finance activities.

(g) NGOs engaged in micro finance and MFIs registered as societies, trusts and cooperatives and engaged in micro finance (i) should have a satisfactory borrowing relationship for at least 3 years with a scheduled commercial bank authorized to deal in foreign exchange in India and (ii) would require a certificate

of due diligence on `fit and proper' status of the Board/ Committee of management of the borrowing entity from the designated AD bank.

(h) Small Industries Development Bank of India (SIDBI) can avail of ECB for onlending to MSME sector, as defined under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. (as amended vide AP DIR Circular No.48 dated 6.11.2012)

(i) Corporates in the services sector viz. hotels, hospitals and software sector.

(j) Companies in miscellaneous services sector (only from overseas direct / indirect equity holders and group companies). Companies in miscellaneous services mean companies engaged in training activities (but not educational institutes), research and development activities and companies supporting infrastructure sector. Companies doing trading business, companies providing logistics services, financial services and consultancy services are, however, not covered under the facility

(k) Holding Companies / Core Investment Companies (CICs) coming under the regulatory framework of the Reserve Bank are permitted to raise ECB for project use in Special Purpose Vehicles (SPVs) provided the business activity of the SPV is in the infrastructure sector where "infrastructure" is defined as per the extant ECB guidelines. The infrastructure project is required to be implemented by the SPV established exclusively for implementing the project and is subject to conditions. In case of Holding Companies that come under the Core Investment Company (CIC) regulatory framework of the Reserve Bank, the ECB availed should be within the ceiling of leverage stipulated for CICs and in case of CICs with asset size below Rs. 100 crore, the ECB availed of should be on fully hedged basis.

ii) Recognised Lenders

Borrowers can raise ECB from internationally recognized sources, such as (a) international banks, (b) international capital markets, (c) multilateral financial institutions (such as IFC, ADB, CDC, etc.) / regional financial institutions and Government owned development financial institutions, (d) export credit agencies, (e) suppliers of equipments, (f) foreign collaborators and (g) foreign equity holders [other than erstwhile Overseas Corporate Bodies (OCBs)].

Minimum requirement for foreign equity holder

A "foreign equity holder" to be eligible as "recognized lender" under the automatic route would require minimum holding of paid-up equity in the borrower company as set out below:

i. For ECB up to USD 5 million – minimum paid-up equity of 25 per cent held directly by the lender (all outstanding ECBs including the proposed one),

ii. For ECB more than USD 5 million – minimum paid-up equity of 25 per cent held directly by the lender and ECB liability-equity ratio not exceeding 4:1

ECB from indirect equity holders is permitted provided the indirect equity holding in the Indian company by the lender is at least 51 per cent.

ECB from a group company is permitted provided both the borrower and the foreign lender are subsidiaries of the same parent

Besides the paid-up capital, free reserves (including the share premium received in foreign currency) as per the latest audited balance sheet shall be reckoned for the purpose of calculating the 'equity' of the foreign equity holder in the term ECB liability-equity ratio. Where there are more than one foreign equity holders in

the borrowing company, the portion of the share premium in foreign currency brought in by the lender(s) concerned shall only be considered for calculating the ECB liability-equity ratio for reckoning quantum of permissible ECB.

For calculating the ‘ECB liability’, not only the proposed borrowing but also the outstanding ECB from the same foreign equity holder lender shall be reckoned

Formalities of overseas organisations /individuals before lending

Overseas organizations and individuals providing ECB need to comply with the following safeguards:

I. Overseas Organizations proposing to lend ECB would have to furnish to the AD bank of the borrower a certificate of due diligence from an overseas bank, which, in turn, is subject to regulation of host-country regulator and adheres to the Financial Action Task Force (FATF) guidelines.

The certificate of due diligence should comprise the following

(i) that the lender maintains an account with the bank for at least a period of two years,

(ii) that the lending entity is organised as per the local laws and held in good esteem by the business/local community and

(iii) that there is no criminal action pending against it.

II. Individual Lender has to obtain a certificate of due diligence from an overseas bank indicating that the lender maintains an account with the bank for at least a period of two years. Other evidence /documents such as audited statement of account and income tax return, which the overseas lender may furnish, need to

be certified and forwarded by the overseas bank. Individual lenders from countries wherein banks are not required to adhere to Know Your Customer (KYC) guidelines are not eligible to extend ECB.

Amount

(i) The maximum amount of ECB which can be raised by a corporate other than those in the hotel, hospital and software sectors, and corporate in miscellaneous services sector is USD 750 million or its equivalent during a financial year

(ii) Corporates in the services sector hotels, hospitals and software sectorand miscellaneous services sector are allowed to avail of ECB up to USD 200 million or its equivalent in a financial year for meeting foreign currency and/ or Rupee capital expenditure for permissible end-uses. The proceeds of the ECBs should not be used for acquisition of land

Maturity

(i) ECB up to USD 20 million or its equivalent in a financial year with minimum average maturity of three years.

(ii) ECB above USD 20 million or equivalent and up to USD 750 million or its equivalent with a minimum average maturity of five years

(iii) ECB up to USD 20 million or equivalent can have call/put option provided the minimum average maturity of three years is complied with before exercising call/put option

All-in cost ceiling

All-in-cost includes rate of interest, other fees and expenses in foreign currency except commitment fee, pre-payment fee, and fees payable in Indian Rupees. The payment of withholding tax in Indian Rupees is excluded for calculating the all-in cost.

The existing all-in-cost ceilings for ECB are as under:

for the respective currency of borrowing or applicable benchmark

In the case of fixed rate loans, the swap cost plus margin should be the equivalent of the floating rate plus the applicable margin.

The rate of penal interest should not be more than 2 per cent of the all-in-cost of ECB.

End use

1. ECB can be raised for investment such as import of capital goods (as classified by DGFT in the Foreign Trade Policy), new projects, modernization/expansion of existing production units in real sector – industrial sector including small and medium enterprises (SME), infrastructure sector and specified service sectors, viz. hotel, hospital and software and miscellaneous services sector as given at I(A)(i)(j) above.

Infrastructure sector is defined as

(a) Energy which will include (i) electricity generation, (ii) electricity transmission, (iii) electricity distribution, (iv) oil pipelines, (v) oil/gas/liquefied natural gas (LNG) storage facility (includes strategic storage of crude oil) and (vi) gas pipelines (includes city gas distribution network);

(b) Communication which will include (i) mobile telephony services / companies providing cellular services, (ii) fixed network telecommunication (includes optic fibre / cable networks which provide broadband / internet) and (iii) telecommunication towers;

(c) Transport which will include (i) railways (railway track, tunnel, viaduct, bridges and includes supporting terminal infrastructure such as loading / unloading terminals, stations and buildings), (ii) roads and bridges, (iii) ports, (iv) inland waterways, (v) airport and (vi) urban public transport (except rolling stock in case of urban road transport);

(d) Water and sanitation which will include (i) water supply pipelines, (ii) solid waste management, (iii) water treatment plants, (iv) sewage projects (sewage collection, treatment and disposal system), (v) irrigation (dams, channels, embankments, etc.) and (vi) storm water drainage system;

(e) (i) mining, (ii) exploration and (iii) refining;

(f) Social and commercial infrastructure which will include (i) hospitals (capital stock and includes medical colleges and para medical training institutes), (ii) Hotel Sector which will include hotels with fixed capital investment of Rs. 200 crore and above, convention centres with fixed capital investment of Rs. 300 crore and above and three star or higher category classified hotels located outside cities with population of more than 1 million (fixed capital investment is excluding of land value), (iii) common infrastructure for industrial parks, SEZs, tourism facilities, (iv) fertilizer (capital investment), (v) post harvest storage infrastructure for agriculture and horticulture produce including cold storage, (vi) soil testing laboratories and (vii) cold chain (includes cold room facility for farm level pre-

cooling, for preservation or storage or agriculture and allied produce, marine products and meat.

2. Overseas Direct Investment in Joint Ventures (JV)/ Wholly Owned Subsidiaries (WOS) subject to the existing guidelines on Indian Direct Investment in JV/ WOS abroad

3. Utilization of ECB proceeds is permitted for first stage as well as subsequent stages of acquisition of shares in the disinvestment process to the public under the Government's disinvestment programme of PSU shares

4. Interest during Construction (IDC) for Indian companies which are in the infrastructure sector, where "infrastructure" is defined as per the extant ECB guidelines, subject to IDC being capitalized and forming part of the project cost

5. For on-lending to self-help groups or for micro-credit or for bonafide micro finance activity including capacity building by NGOs engaged in micro finance activities.

6. Maintenance and operations of toll systems for roads and highways for capital expenditure provided they form part of the original project

7. ECB for general corporate purposes from direct foreign equity holders by companies in manufacturing, infrastructure, hotels, hospitals and software sector:

Eligible borrowers can avail ECB from their direct foreign equity holder company with a minimum average maturity of 7 years for general corporate purposes (which includes working capital) subject to the following conditions:

i. Minimum paid-up equity of 25 per cent should be held directly by the lender;

ii. Such ECBs would not be used for any purpose not permitted under extant the ECB guidelines (including on-lending to their group companies / step-down subsidiaries in India); and Repayment of the principal shall commence only after completion of minimum average maturity of 7 years

iii. No prepayment will be allowed before maturity

8. Payment for Spectrum Allocation:

(A) Relaxation for the successful Bidders of 2G spectrum Re-auction

(i) to make the upfront payment initially out of Rupee loans availed of from the domestic lenders and refinance such Rupee loans with a long-term ECB provided such ECB is raised within a period of 18 months from the date of sanction of such Rupee loans for the stated purpose from the domestic lenders.

(ii) Availing of short term foreign currency loan in the nature of bridge finance for the purpose of making upfront payment and replace the same with a long term ECB subject to condition that the long term ECB is raised within a period of 18 months from the date of drawdown of the bridge finance.

(iii) ECB can be availed of from their ultimate parent company without any maximum ECB liability-equity ratio subject to the condition that the lender holds minimum paid-up equity of 25 per cent in the borrower company, either directly or indirectly.

(iv) Such ECB cannot be raised from overseas branches / subsidiaries of Indian banks

End use not permitted

Other than the purposes specified hereinabove, the borrowings shall not be utilized for any other purpose including the following purposes, namely:

(a) For on-lending or investment in capital market or acquiring a company (or a part thereof) in India by a corporate [investment in Special Purpose Vehicles (SPVs), Money Market Mutual Funds (MMMFs), etc., are also considered as investment in capital markets].

(b) for real estate sector,

(c) for general corporate purpose which includes working capital (other than what has been given at I(A)(v)(l) above) and repayment of existing rupee loans

Note: The proceeds of the ECBs should not be used for acquisition of land.

Issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by banks, Financial Institutions and Non-Banking Financial Companies (NBFCs) from India relating to ECB is not permitted

Security against loan

The choice of security to be provided to the overseas lender / supplier for securing ECB is left to the borrower. AD Category-I banks may allow creation of charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised / raised by the borrower, subject to satisfying themselves that: –

i. the underlying ECB is in compliance with the extant ECB guidelines,

ii. there exists a security clause in the Loan Agreement requiring the ECB borrower to create charge, in favour of overseas lender / security trustee, on immovable assets / movable assets / financial securities / issuance of corporate and / or personal guarantee,

iii. No objection certificate, wherever necessary, from the existing lenders in India has been obtained.

Once aforesaid stipulations are met, the AD Category-I bank may permit creation of charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees, during the currency of the ECB with security co-terminating with underlying ECB, subject to the following:

(a) Creation of Charge on immovable assets:

i. Such security shall be subject to provisions contained in the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000

ii. The permission should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender / security trustee.

iii. In the event of enforcement / invocation of the charge, the immovable asset / property will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB

(b) Creation of Charge on Movable Assets

In the event of enforcement / invocation of the charge, the claim of the lender, whether the lender takes over the movable asset or otherwise, will be restricted

to the outstanding claim against the ECB. Encumbered movable assets may also be taken out of the country.

(c) Creation of Charge over Financial Securities

i. Pledge of shares of the borrowing company held by the promoters as well as in domestic associate companies of the borrower will be permitted. Pledge on other financial securities, viz. bonds and debentures, Government Securities, Government Savings Certificates, deposit receipts of securities and units of the Unit Trust of India or of any mutual funds, standing in the name of ECB borrower/promoter, will also be permitted.

ii. In addition, security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower with AD Category-I banks in India, standing in the name of the borrower/promoter, can be used as security for ECB. The Rupee accounts of the borrower/promoter can also be in the form of escrow arrangement or debt service reserve account

iii. In case of invocation of pledge, transfer of financial securities shall be in accordance with the extant FDI/FII policy including provisions relating to sectoral cap and pricing as applicable read with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000

(d) Issue of Corporate or Personal Guarantee

i. A copy of Board Resolution for the issue of corporate guarantee for the company issuing such guarantee, specifying name of the officials authorised to

execute such guarantees on behalf of the company or in individual capacity should be obtained.

ii. Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained.

Procedure

1. Applicants are required to submit an application in form ECB through designated AD bank to the Principal Chief General Manager, Foreign Exchange Department, Reserve Bank of India, Central Office, External Commercial Borrowings Division, Mumbai – 400 001, along with necessary documents

2. Borrowers may enter into loan agreement complying with the ECB guidelines with recognised lender for raising ECB under the Automatic Route without the prior approval of the Reserve Bank. The borrower must obtain a Loan Registration Number (LRN) from the Reserve Bank of India before drawing down the ECB. The procedure for obtaining LRN is detailed as:

i. For allotment of Loan Registration Number (LRN), borrowers are required to submit Form 83, in duplicate, certified by the Company Secretary (CS) or Chartered Accountant (CA) to the designated AD bank. One copy is to be forwarded by the designated AD bank to the Director, Balance of Payments Statistics Division, Department of Statistics and Information Management (DSIM), Reserve Bank of India, Bandra-Kurla Complex, Mumbai – 400 051(Note: copies of loan agreement and offer documents for FCCB are not required to be submitted with Form 83).

ii. The borrower can draw-down the loan only after obtaining the LRN from DSIM, Reserve Bank.

iii. Borrowers are required to submit ECB-2 Return certified by the designated AD bank on monthly basis so as to reach DSIM, Reserve Bank within seven working days from the close of month to which it relates.

Q5)Short notes (15)

A)Primary market:-Market where securities are issued for the frist time. b)CIMC:-Collective Investment Management Scheme

c)Derivatives:-Derived from other securities.

d)IOSCO: International Organisation fpr securities Commissions

e)Fundgibility: A financial instrument (such as a stock, bond or futures contract) is considered fungible if it can be bought/sold on one market or exchange, and then sold/bought on another market or exchange. ... In trading, fungibilityimplies the ability to buy or sell the same financial instrument in two or more different markets.