



Back Office Operations Module



NATIONAL STOCK EXCHANGE OF INDIA LIMITED

Test Details:

Sr. No.	Name of Module	Fees (Rs.)	Test Duration (in minutes)	No. of Questions	Maximum Marks	Pass Marks (%)	Certificate Validity
1	Financial Markets: A Beginners' Module *	1686	120	60	100	50	5
2	Mutual Funds : A Beginners' Module	1686	120	60	100	50	5
3	Currency Derivatives: A Beginner's Module	1686	120	60	100	50	5
4	Equity Derivatives: A Beginner's Module	1686	120	60	100	50	5
5	Interest Rate Derivatives: A Beginner's Module	1686	120	60	100	50	5
6	Commercial Banking in India: A Beginner's Module	1686	120	60	100	50	5
7	Securities Market (Basic) Module	1686	120	60	100	60	5
8	Capital Market (Dealers) Module *	1686	105	60	100	50	5
9	Derivatives Market (Dealers) Module *	1686	120	60	100	60	3
10	FIMMDA-NSE Debt Market (Basic) Module	1686	120	60	100	60	5
11	Investment Analysis and Portfolio Management Module	1686	120	60	100	60	5
12	Fundamental Analysis Module	1686	120	60	100	60	5
13	Financial Markets (Advanced) Module	1686	120	60	100	60	5
14	Securities Markets (Advanced) Module	1686	120	60	100	60	5
15	Mutual Funds (Advanced) Module	1686	120	60	100	60	5
16	Banking Sector Module	1686	120	60	100	60	5
17	Insurance Module	1686	120	60	100	60	5
18	Macroeconomics for Financial Markets Module	1686	120	60	100	60	5
19	NISM-Series-I: Currency Derivatives Certification Examination	1000	120	100	100	60	3
20	NISM-Series-II-A: Registrars to an Issue and Share Transfer Agents – Corporate Certification Examination	1000	120	100	100	50	3
21	NISM-Series-II-B: Registrars to an Issue and Share Transfer Agents – Mutual Fund Certification Examination	1000	120	100	100	50	3
22	NISM-Series-IV: Interest Rate Derivatives Certification Examination	1000	120	100	100	60	3
23	NISM-Series-V-A: Mutual Fund Distributors Certification Examination *	1000	120	100	100	50	3
24	NISM-Series-VI: Depository Operations Certification Examination	1000	120	100	100	60	3
25	NISM Series VII: Securities Operations and Risk Management Certification Examination	1000	120	100	100	50	3
26	Certified Personal Financial Advisor (CPFA) Examination	4495	120	80	100	60	3
27	NSDL-Depository Operations Module	1686	75	60	100	60 #	5
28	Commodities Market Module	2022	120	60	100	50	3
29	Surveillance in Stock Exchanges Module	1686	120	50	100	60	5
30	Corporate Governance Module	1686	90	100	100	60	5
31	Compliance Officers (Brokers) Module	1686	120	60	100	60	5
32	Compliance Officers (Corporates) Module	1686	120	60	100	60	5
33	Information Security Auditors Module (Part-1)	2528	120	90	100	60	2
	Information Security Auditors Module (Part-2)	2528	120	90	100	60	
34	Options Trading Strategies Module	1686	120	60	100	60	5
35	Options Trading (Advanced) Module	1686	120	35	100	60	5
36	FPSB India Exam 1 to 4**	2247 per exam	120	75	140	60	NA
37	Examination 5/Advanced Financial Planning **	5618	240	30	100	50	NA
38	Equity Research Module ##	1686	120	65	100	55	2
39	Issue Management Module ##	1686	120	80	100	55	2
40	Market Risk Module ##	1686	120	50	100	55	2
41	Financial Modeling Module ###	1123	150	50	75	50	NA

* Candidates have the option to take the tests in English, Gujarati or Hindi languages.

Candidates securing 80% or more marks in NSDL-Depository Operations Module ONLY will be certified as 'Trainers'.

** Following are the modules of Financial Planning Standards Board India (Certified Financial Planner Certification)

- FPSB India Exam 1 to 4 i.e. (i) Risk Analysis & Insurance Planning (ii) Retirement Planning & Employee Benefits (iii) Investment Planning and (iv) Tax Planning & Estate Planning
- Examination 5/Advanced Financial Planning

Modules of Finitatives Learning India Pvt. Ltd. (FLIP)

Module of IMS Proschool

The curriculum for each of the modules (except Financial Planning Standards Board India, Finitatives Learning India Pvt. Ltd. and IMS Proschool) is available on our website: www.nseindia.com > Education > Certifications.

Back Office Operations Module

Background

This Workbook focuses on the operations in the back office of various market intermediaries, in connection with the primary issue of securities by companies or mutual funds and the secondary market trading in those securities.

This Workbook presumes that candidates know the fundamentals of these products and institutions.

Suitability of various financial products to investors, or to the organisations that issue them, being irrelevant from a back-office perspective, is not covered in the Workbook. Legal aspects of the activities are covered in the Workbook only to the extent they have a bearing on the back-office operations.

For better understanding of the products discussed and deeper insights into legalities, candidates are strongly advised to refer to the relevant modules in NCFM's suite of workbooks.

Learning Objectives

- To understand the operational aspects of 'Know Your Client' requirements, get exposed to how client relationships are initiated in the securities market and recognise the reporting requirements mandated by the government's 'Anti-money laundering' and 'Countering Financing of Terrorism' initiatives
- To know the various types of primary issues and the activities that drive the primary market
- To get an overview of the different segments of NSE, and gain insights on post-trade activities in the market
- To appreciate on the role of depositories and various activities that are handled by depositories and depository participants
- To understand the role and responsibilities of Registrar & Transfer Agents, and recognise their difference from depositories
- To know the various activities that support mutual fund operations, in the Asset Management Company as well as in the overall mutual fund eco-system, including the secondary market for mutual fund schemes
- To understand the processes mandated by SEBI for Qualified Foreign Investors to invest in Indian equity shares and mutual fund schemes

CONTENTS

Acronyms	7
CHAPTER 1 : KYC, AML & CFT	10
1.1 Principles.....	11
1.2 Client Due Diligence	12
1.3 Customer Acceptance Policy	12
1.4 Clients of Special Category (CSC)	13
1.5 Client Identification Procedure (CIP).....	14
1.6 Client Registration	15
1.6.1 Proof of Identity (POI)	16
1.6.2 Proof of Address (POA)	16
1.6.3 PAN Card	16
1.6.4 Additional Requirements for non-individuals	18
1.6.5 Unique Client Code.....	18
1.6.6 Nomination	18
1.7 Changes in Client Information	19
1.7.1 Change of Address	19
1.7.2 Change in Bank Details.....	19
1.7.3 Change in Signatory	19
1.8 KYC Registration Agencies (KRA)	19
1.9 Suspicious Transactions Reporting (STR).....	22
1.10 Designated Individuals & Entities	23
1.11 Record Keeping	23
Self-Assessment Questions	24
CHAPTER 2 : PRIMARY MARKET	26
2.1 Types of Issues	26
2.1.1 Public Issue - IPO	26
2.1.2 Public Issue – Follow-on Offering.....	26

2.1.3	Public Issue – Offer for Sale	26
2.1.4	Rights Issue	26
2.1.5	Bonus Issue	27
2.1.6	Private Placement	27
2.1.7	GDR / ADR Issues	28
2.1.8	Sponsored GDR / ADR Issues	29
2.1.9	Foreign Currency Convertible Bond (FCCB) Issues	29
2.1.10	India Depository Receipts.....	30
2.2	Public Issue Process	30
2.3	Time-line for Public Issue.....	34
2.4	Common Bid-cum-Application Form.....	37
2.5	ASBA	38
2.6	Buy Back of Securities.....	39
Appendix 2.1		42
Self-Assessment Questions		46
CHAPTER 3 : SECONDARY MARKET (TRADING IN SHARES)		47
3.1	National Stock Exchange	47
3.2	Trading Members & Clearing Members	47
3.3	Authorised Persons & Sub-brokers	48
3.4	Trading Member’s Responsibilities for Trades	48
3.5	Uniform Documentation for Opening Trading Account	50
3.6	Screen-based Trading System (SBTS).....	50
3.7	Trade Management	50
3.8	Market Types	51
3.8.1	Normal Market.....	51
3.8.2	Auction Market	51
3.8.3	Odd Lot Market.....	52
3.8.4	Retail Debt Market	52

3.9	Margin Trading	52
3.10	Exchange Margins.....	53
3.11	Settlement	53
3.11.1	Clearing House	53
3.11.2	Other Agencies Involved in Settlement	53
3.11.3	Clearing Mechanism	55
3.11.4	Clearing Process	55
3.11.5	Settlement Process	55
3.11.6	Transaction Cycle.....	56
3.11.7	T+2 Rolling Settlement Calendar.....	58
3.11.8	Delivery Versus Payment (DVP) / Hand Delivery	59
3.11.9	Auction Settlement	59
3.11.10	F&O Settlement	60
3.11.11	Books of Accounts.....	66
3.11.12	Straight Through Processing (STP)	67
	Annexures – Uniform Documentation for Opening Trading Account	68
	Self-Assessment Questions	95
	CHAPTER 4 : DEPOSITORY OPERATIONS	96
4.1	Depository and Issuer	96
4.2	Depository Participant	97
4.3	Transactions	97
4.3.1	Account Opening.....	97
4.3.2	De-materialisation	97
4.3.3	Re-materialisation.....	98
4.3.4	Secondary Market Purchases	99
4.3.5	Secondary Market Sales.....	99
4.3.6	Standing Instructions	99
4.3.7	Power of Attorney (PoA).....	100

4.3.8	Transposition.....	100
4.3.9	Transmission of Securities	100
4.3.10	Dividends	101
4.3.11	Pledging Securities.....	101
4.3.12	Freezing of Accounts	101
4.3.13	SMS Alerts	102
	Self-Assessment Questions	103
CHAPTER 5 : REGISTRAR & TRANSFER AGENT		104
5.1	Role& Responsibilities.....	104
5.2	Voting Rights in Companies.....	105
5.3	Dividend Payments in Companies.....	107
5.4	Physical Shares	108
5.4.1	Transfer Deed.....	108
5.4.2	Delays in Transfer of Shares by Companies.....	108
5.4.3	Good and Bad Delivery Norms	109
	Self-Assessment Questions	125
CHAPTER 6 : MUTUAL FUND: AMC OPERATIONS.....		126
6.1	Legal Structure	126
6.2	Net Asset Value (NAV).....	127
6.3	Expenses.....	129
6.4	Load	130
6.5	Offer Documents	131
6.6	Investor Transactions (Normal Physical Mode)	131
6.6.1	Acquisition of Units by Investor from the Scheme.....	131
6.6.2	Sale of Units by Investor to Scheme	132
6.6.3	Secondary Market Transactions in Units by Investor.....	133
6.6.4	Redemption of Units on closure of scheme.....	133
6.6.5	Additional Purchase by Investor	133

6.6.6	Switch by Investor	133
6.6.7	Systematic Investment Plan	134
6.6.8	Systematic Withdrawal Plan.....	134
6.6.9	Systematic Transfer Plan.....	134
6.7	Investor Transactions (Through the Internet)	134
6.8	Investor Transactions (NSE MFSS Channel)	135
6.9	Dividend Options	135
6.9.1	Dividend Payout Option.....	135
6.9.2	Growth Option.....	135
6.9.3	Dividend Re-investment Option.....	135
6.10	Dividend Mechanics	136
6.11	Income Distribution Tax.....	136
6.12	Securities Transaction Tax (STT)	137
6.13	Cut-off Time Regulations	138
6.13.1	Liquid Schemes & Plans - Subscriptions	139
6.13.2	Liquid Schemes & Plans – Re-Purchases.....	140
6.13.3	Other than Liquid Schemes & Plans - Subscriptions.....	140
6.13.4	Other than Liquid Schemes & Plans – Re-purchases.....	141
6.14	Official Points of Acceptance (PoA)	141
6.15	Time Stamping.....	141
6.16	RTA Role	142
6.17	Distributors' Commission	143
6.18	Bank Accounts	144
6.19	Other Back Office Activities	144
	Self-Assessment Questions	145
	CHAPTER 7 : MUTUAL FUND TRANSACTIONS THROUGH NSE	146
7.1	Listed Schemes	146
7.2	Exchange Traded Funds (ETFs)	147

7.3	Mutual Fund Service System (MFSS)	147
7.3.1	Subscription (Physical mode).....	148
7.3.2	Subscription (Demat mode).....	150
7.3.3	Redemption (Physical mode)	151
7.3.4	Redemption (Demat mode)	153
	Self-Assessment Questions	155
	CHAPTER 8 : QUALIFIED FOREIGN INVESTORS – EQUITY SHARES.....	156
8.1	Background	156
8.2	Permitted Transactions	157
8.3	Investment Restrictions.....	157
8.4	Administration of Investment Limit	158
8.5	Other Conditions	160
8.6	Transaction Flow.....	162
	Self-Assessment Questions	163
	CHAPTER 9 : QUALIFIED FOREIGN INVESTORS – MUTUAL FUNDS.....	164
9.1	Background	164
9.2	Investment Limit	164
9.3	Transaction Flow.....	164
9.3.1	Direct Route (Demat).....	164
9.3.2	Indirect Route (Unit Confirmation Receipts – UCR)	165
9.4	Other Conditions	167
	Self-Assessment Questions	168

Acronyms

ADR	American Depositary Receipt
AMFI	Association of Mutual Funds in India
AML	Anti-Money Laundering
AoP	Association of Persons
ASBA	Application Supported by Blocked Amount
AUM	Assets Under Management
CC	Clearing Corporation
CDD	Client Due Diligence
CDS	Currency Derivatives Segment
CH	Clearing House
CIP	Client Identification Procedure
CIS	Collective Investment Schemes
CFT	Combating Financing of Terrorism
CM	Capital Market
CP	Custodial Participants
CSC	Clients of Special Category
DDT	Dividend Distribution Tax
DIN	Director Identification Number
DP	Depository Participant
DPS	Dividend Per Share
DRF	Dematerialisation Request Form
DRN	Dematerialisation Request Number
DVP	Delivery Versus Payment
DVR	Differential Voting Rights
EC	European Commission
ECN	Electronic Contract Note
EPS	Earnings Per Share
ETF	Exchange Traded Fund
FCCB	Foreign Currency Convertible Bonds
F&O	Futures & Options
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act
FII	Foreign Institutional Investor
FPO	Follow-on Public Offer
FVCI	Foreign Venture Capital Investor
GDR	Global Depositary Receipt
GOI	Government of India
HUF	Hindu Undivided Family
IDR	India Depositary Receipts
IPO	Initial Public Offer
IPV	In-Person Verification
IRDA	Insurance Regulatory & Development Authority
ISC	Investor Service Centres
ISIN	International Securities Identification Number

KIM	Key Information Memorandum
KRA	KYC Registration Agencies
KYC	Know Your Client
KYD	Know Your Distributor
MF	Mutual Fund
MFSS	Mutual Fund Service System
MMOU	Multi-lateral Memorandum of Understanding
MTM	Marked to Market
NAV	Net Asset Value
NEAT	National Exchange for Automated Trading
NFO	New Fund Offer
NISM	National Institute of Securities Market
NOC	No-Objection Certificate
NSCCL	National Securities Clearing Corporation Limited
NSE	National Stock Exchange
OCI	Overseas Citizen of India
PAN	Permanent Account Number
PIO	Person of Indian Origin
PMLA	Prevention of Money Laundering Act
POA	Power of Attorney
POA	Proof of Address
POA	Points of Acceptance
POI	Proof of Identity
QFI	Qualified Foreign Investor
QIB	Qualified Institutional Buyer
QIP	Qualified Institutional Placement
RBI	Reserve Bank of India
RRF	Re-materialisation Request Form
RTA	Registrar & Transfer Agent
SAI	Statement of Additional Information
SBTS	Screen-based Trading System
SCSB	Self-Certified Syndicate Bank
SEBI	Securities & Exchange Board of India
SID	Scheme Information Document
SIP	Systematic Investment Plan
SOA	Statement of Account
STP	Systematic Transfer Plan
STP	Straight Through Processing
STR	Suspicious Transactions Reporting
STT	Securities Transaction Tax
SWP	Systematic Withdrawal Plan
TDS	Tax Deducted at Source
UCR	Unit Confirmation Receipt
VCF	Venture Capital Fund
WDM	Wholesale Debt Market

Distribution of weights of the Back Office Operations Module Curriculum

Chapter No.	Title	Weights (%)
1	KYC, AML & CFT	20
2	Primary Market	15
3	Secondary Market	15
4	Depository Operations	10
5	Registrar & Transfer Agent	10
6	Mutual Fund : AMC Operations	15
7	Mutual Fund Transactions through NSE	10
8	Qualified Foreign Investors : Equity Shares	2.5
9	Qualified Foreign Investors : Mutual Funds	2.5

Note: Candidates are advised to refer to NSE's website: www.nseindia.com, click on 'Education' link and then go to 'Updates & Announcements' link, regarding revisions/updates in NCFM modules or launch of new modules, if any.

This book has been developed for NSE by Mr. Sundar Sankaran, Director, Finberry Academy Pvt. Ltd.

Copyright © 2012 by National Stock Exchange of India Ltd. (NSE)
Exchange Plaza, Bandra Kurla Complex,
Bandra (East), Mumbai 400 051 INDIA

All content included in this book, such as text, graphics, logos, images, data compilation etc. are the property of NSE. This book or any part thereof should not be copied, reproduced, duplicated, sold, resold or exploited for any commercial purposes. Furthermore, the book in its entirety or any part cannot be stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise.

Chapter 1 : KYC, AML & CFT

The G-7 summit in 1989 established the Financial Action Task Force (FATF). India has a status of member in FATF.

In 1990, FATF came out with 40 recommendations to fight money laundering. 9 recommendations to combat terrorism financing were added in 2001.

In India, The Prevention of Money Laundering Act, 2002 (PMLA) came into effect on July 1, 2005. On the same day, the Financial Intelligence Unit-India (FIU-IND) constituted by Government of India on 18th November 2004 as a nodal agency for AML measures, got statutory recognition.

The provisions of the PMLA are applicable to every:

- Banking company
- Financial institution (includes chit fund company, a co-operative bank, a housing finance institution and a non-banking financial company) and
- Intermediary [includes a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, asset management company, depository participant, merchant banker, underwriter, portfolio manager, investment adviser and any other intermediary associated with the securities market and registered under Section 12 of the Securities and Exchange Board of India Act, 1992 (SEBI Act)]

PMLA requires these entities to adhere to client account opening procedures and maintain records of such transactions as prescribed by the PMLA and Rules notified there under.

Accordingly, SEBI has come out with various directives for its regulated intermediaries. These cover Know Your Client (KYC) norms, Anti-Money Laundering (AML), Client Due Diligence (CDD) and Combating Financing of Terrorism (CFT).

Branches and subsidiaries of intermediaries, located abroad, especially, in countries which do not apply or insufficiently apply the FATF Recommendations, too are required to comply with SEBI directives, to the extent local laws and regulations permit. When local applicable laws and regulations prohibit implementation of the SEBI requirements, the same has to be brought to the notice of SEBI. In case there is a variance in CDD/ AML standards prescribed by SEBI and the regulators of the host country, branches/overseas subsidiaries of intermediaries are required to adopt the more stringent requirements of the two.

The SEBI directives are the minimum that are mandated. Every intermediary is free to add other requirements as part of AML and CFT.

1.1 Principles

Senior management of a registered intermediary have to be fully committed to establishing appropriate policies and procedures for the prevention of money laundering and terrorist financing and ensuring their effectiveness and compliance with all relevant legal and regulatory requirements. The Registered Intermediaries need to:

- Issue a statement of policies and procedures, on a group basis where applicable, for dealing with money laundering and terrorist financing reflecting the current statutory and regulatory requirements;
- Ensure that the content of these Directives are understood by all staff members;
- Regularly review the policies and procedures on the prevention of money laundering and terrorist financing to ensure their effectiveness. Further, in order to ensure the effectiveness of policies and procedures, the person doing such a review should be different from the one who has framed such policies and procedures;
- Adopt client acceptance policies and procedures which are sensitive to the risk of money laundering and terrorist financing;
- Undertake client due diligence ("CDD") measures to an extent that is sensitive to the risk of money laundering and terrorist financing depending on the type of client, business relationship or transaction;
- Have a system in place for identifying, monitoring and reporting suspected money laundering or terrorist financing transactions to the law enforcement authorities; and
- Develop staff members' awareness and vigilance to guard against money laundering and terrorist financing.

Policies and procedures to combat money laundering have to cover:

- Communication of group policies relating to prevention of money laundering and terrorist financing to all management and relevant staff that handle account information, securities transactions, money and client records etc. whether in branches, departments or subsidiaries;
- Client acceptance policy and client due diligence measures, including requirements for proper identification;
- Maintenance of records;
- Compliance with relevant statutory and regulatory requirements;
- Co-operation with the relevant law enforcement authorities, including the timely disclosure of information;
- Role of internal audit or compliance function to ensure compliance with the policies, procedures, and controls relating to the prevention of money laundering and terrorist

financing, including the testing of the system for detecting suspected money laundering transactions, evaluating and checking the adequacy of exception reports generated on large and/or irregular transactions, the quality of reporting of suspicious transactions and the level of awareness of front line staff, of their responsibilities in this regard.

1.2 *Client Due Diligence*

The CDD includes the following:

- Obtain sufficient information in order to identify persons who beneficially own or control the securities account.

Whenever it is apparent that the securities acquired or maintained through an account are beneficially owned by a party other than the client, that party should be identified using client identification and verification procedures.

The beneficial owner is the natural person or persons who ultimately own, control or influence a client and/or persons on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.

- Verify the client's identity using reliable, independent source documents, data or information;
- Identify beneficial ownership and control, i.e. determine which individual(s) ultimately own(s) or control(s) the client and/or the person on whose behalf a transaction is being conducted;
- Verify the identity of the beneficial owner of the client and/or the person on whose behalf a transaction is being conducted, corroborating the information provided in relation to the previous para; and
- Conduct ongoing due diligence and scrutiny, i.e. perform ongoing scrutiny of the transactions and account throughout the course of the business relationship to ensure that the transactions being conducted are consistent with the registered intermediary's knowledge of the client, its business and risk profile, taking into account, where necessary, the client's source of funds.

1.3 *Customer Acceptance Policy*

All registered intermediaries have to develop client acceptance policies and procedures that aim to identify the types of clients that are likely to pose a higher than the average risk of money laundering or terrorist financing. The following safeguards are to be followed while accepting the clients:

- No account is opened in a fictitious / benami name or on an anonymous basis.

- Factors of risk perception (in terms of monitoring suspicious transactions) of the client are clearly defined having regard to clients' location (registered office address, correspondence addresses and other addresses if applicable), nature of business activity, trading turnover etc. and manner of making payment for transactions undertaken. The parameters should enable classification of clients into low, medium and high risk.
- Clients of special category (as detailed in the next section) may, if necessary, be classified even higher. Such clients require higher degree of due diligence and regular update of Know Your Client (KYC) profile.
- Documentation requirement and other information to be collected in respect of different classes of clients depending on perceived risk and having regard to the requirements of PML Rules, Directives and Circulars issued by SEBI from time to time.
- Ensure that an account is not opened where the intermediary is unable to apply appropriate CDD measures / KYC policies. This may be applicable in cases where it is not possible to ascertain the identity of the client, or the information provided to the intermediary is suspected to be non-genuine, or there is perceived non co-operation of the client in providing full and complete information.

The market intermediary should not continue to do business with such a person and file a suspicious activity report. It should also evaluate whether there is suspicious trading in determining whether to freeze or close the account. The market intermediary should be cautious to ensure that it does not return securities of money that may be from suspicious trades.

The market intermediary should consult the relevant authorities in determining what action it should take when it suspects suspicious trading.

- Necessary checks and balances to be put into place before opening an account so as to ensure that the identity of the client does not match with any person having known criminal background or is not banned in any other manner, whether in terms of criminal or civil proceedings by any enforcement agency worldwide.

1.4 *Clients of Special Category (CSC)*

This includes the following:

- Non-resident clients
- High net-worth clients
- Trust, Charities, Non-Governmental Organizations (NGOs) and organizations receiving donations
- Companies having close family shareholdings or beneficial ownership
- Politically Exposed Persons (PEP) viz. individuals who are or have been entrusted with

prominent public functions in a foreign country, e.g., Heads of States or of Governments, senior politicians, senior government/ judicial/ military officers, senior executives of state-owned corporations, important political party officials, etc.

Additional norms applicable to PEP (detailed later in this chapter) are also be applied to the accounts of the family members or close relatives of PEPs.

- Companies with foreign exchange offerings
- Clients in high risk countries where existence / effectiveness of money laundering controls is suspect, where there is unusual banking secrecy, countries active in narcotics production, countries where corruption (as per Transparency International Corruption Perception Index) is highly prevalent, countries against which government sanctions are applied, countries reputed to be any of the following –
 - o Havens / sponsors of international terrorism,
 - o Offshore financial centers
 - o Tax havens
 - o Countries where fraud is highly prevalent.
- Non face-to-face clients
- Clients with dubious reputation as per public information available etc.

The above mentioned list is only illustrative and the intermediary has to exercise independent judgment to ascertain whether any other set of clients should be classified as CSC.

1.5 Client Identification Procedure (CIP)

The KYC policy should clearly spell out the client identification procedure to be carried out at different stages i.e. while establishing the intermediary – client relationship, while carrying out transactions for the client or when the intermediary has doubts regarding the veracity or the adequacy of previously obtained client identification data.

CIP has to include the following:

- All registered intermediaries should put in place necessary procedures to determine whether their existing/potential client is a PEP. Such procedures would include seeking additional information from clients, accessing publicly available information etc.
- All registered intermediaries are required to obtain senior management approval for establishing business relationships with PEPs.

Where a client has been accepted and the client or beneficial owner is subsequently found to be, or subsequently becomes a PEP, registered intermediaries have to obtain senior management approval to continue the business relationship.

- Registered intermediaries have to take reasonable measures to verify source of funds of clients identified as PEP.

- The client should be identified by the intermediary by using reliable sources including documents / information. The intermediary should obtain adequate information to satisfactorily establish the identity of each new client and the purpose of the intended nature of the relationship.
- The information should be adequate enough to satisfy competent authorities (regulatory / enforcement authorities) in future that due diligence was observed by the intermediary in compliance with the directives. Each original document should be seen prior to acceptance of a copy.
- Failure by prospective client to provide satisfactory evidence of identity should be noted and reported to the higher authority within the intermediary.

There is no minimum investment threshold/ category-wise exemption available for carrying out CDD measures by registered intermediaries.

1.6 Client Registration

Client registration formalities are to be completed, before commencing transactions with a client. Depending on the nature of business of the intermediary, there are minor changes in documentation. The following are the mandatory documents for Trading Members in the stock exchange:

- KYC Form

This includes complete details of Client information / Status, Bank and Depository Account details, Financial details of the constituent (i.e. the client), Investment/ Trading experience, References, Financial documents (for Non Individual Constituents) and Signature of client.

Photograph, Proof of identity and address, and Board Resolution from corporate clients permitting trading in derivative products are attached.

Name and address of the applicant mentioned in the KYC form has to match with the documentation provided.

Sole proprietor must make the application in his individual name & capacity.

The segments in which a client wants to transact are selected and marked by the client clearly.

- Risk Disclosure Document (RDD)

As part of the RDD, the client is made aware that certain basic risks are involved in trading in equity and derivative products.

Client acknowledgement has to be taken on the RDD.

Client should be made aware that contracts cannot be rescinded on the ground of lack of awareness or any other ground.

The trading member must ensure periodic review of client's financial information & client database.

Any non-mandatory client requirements prescribed by the intermediary are to be taken as separate documents.

Some of the documentation requirements, applicable to both individual and institutional clients, are as follows:

1.6.1 Proof of Identity (POI)

The list of acceptable documents is mentioned in the Annexures to Chapter 3.

If any proof of identity or address is in a foreign language, then translation into English is required.

1.6.2 Proof of Address (POA)

The list of acceptable documents is mentioned in the Annexures to Chapter 3.

If correspondence & permanent address are different, then proofs for both have to be submitted.

The proof of address in the name of the spouse may be accepted.

A copy of the Power of Attorney (POA) given by the Foreign Institutional Investors (FIIs)/ FII sub-accounts to the Custodians (which are duly notarized and/or apostiled or consularised) that gives the registered address of the FIIs/sub-accounts can be accepted as proof of their address.

In case of NRIs, authorized officials of overseas branches of Scheduled Commercial Banks registered in India, Notary Public, Court Magistrate, Judge, Indian Embassy /Consulate General in the country where the client resides are permitted to attest the documents.

1.6.3 PAN Card

Permanent Account Number (PAN) is mandatory for all entities/ persons who wish to transact in the securities market. It is the sole identification number for all participants transacting in the securities market, irrespective of the amount of transaction.

PAN may not be insisted in the case of securities market transactions undertaken on behalf of Central Government and State Government, and by the officials appointed by the courts e.g. Official liquidator, Court receiver etc. (under the category of Government).

Investors residing in the State of Sikkim are exempted from the mandatory requirement of PAN for-

- (a) Depository Participant (DP)
- (b) Broker
- (c) Mutual Fund

However, the intermediary needs to check the veracity of the claim of the investors that they are residents of Sikkim, by collecting sufficient documentary evidence in support of their address.

In the case of institutional clients, the Custodian has to verify the PAN details and provide the verified details, duly certified. Institutional clients include FIIs, Mutual Funds (MFs), Venture Capital Funds (VCFs), Foreign Venture Capital Investor (FVCIs), Scheduled Commercial Banks, Multilateral and Bilateral Development Financial Institutions, State Industrial Development Corporations, Insurance Companies registered with Insurance Regulatory & Development Authority (IRDA) and Public Financial Institution as defined under section 4A of the Companies Act, 1956.

In the case of Hindu Undivided Family (HUF), Association of Persons (AoP), Partnership Firm, unregistered Trust etc., beneficiary ownership would be in the name of natural persons. PAN of the respective HUF, AoP, Partnership Firm, Unregistered Trust, etc is to be obtained.

For Registered Trust and Corporate Bodies, PAN of the respective entities is to be obtained when accounts are opened in their respective names.

Citizens of India residing outside India, foreign citizens and other persons (like companies/ trusts/ firms) having no office of their own in India are expected to obtain PAN based on the copy of their passport as ID proof and a copy of passport/ bank account in the country of residence as address proof.

It is mandatory to furnish a copy of PAN in the following cases –

- Deletion of name of the deceased shareholder(s), where the shares are held in the name of two or more shareholders.
- Transmission of shares to the legal heir(s), where deceased shareholder was the sole holder of shares.
- Transposition of shares – when there is a change in the order of names in which physical shares are held jointly in the names of two or more shareholders.

The following are the procedural requirements regarding verification of PAN:

- Collect self-attested copies of PAN cards issued by the Income Tax Department to existing as well as new clients.

Maintain the same in the records after verifying with the original.

- Cross-check the PAN details collected from the clients with the details on the website of the Income Tax Department i.e. <http://incometaxindiaefiling.gov.in/challan/enterpanforchallan.jsp>.
- Upload details of PAN to the Exchanges as part of unique client Code.

In the case of slight mismatch in PAN card details as well as difference in maiden name and current name (predominantly in the case of married women) of the investors, DPs

can collect the PAN card proof as submitted by the account holder. However, this would be subject to the DPs verifying the veracity of the claim of such investors by collecting sufficient documentary evidence in support of the identity of the investors.

1.6.4 Additional Requirements for non-individuals

The list of acceptable documents for different categories of non-individuals is mentioned in the Annexures to Chapter 3.

1.6.5 Unique Client Code

It is mandatory for the trading member to use a Unique Client Code for each client.

The trading member has to verify the documents with respect to the unique code and retain a copy of the document.

1.6.6 Nomination

Nomination makes it simpler to transfer assets to the nominee on the death of the holder/s. It is advisable to have nomination for all assets where it is permitted, including demat accounts.

Since 2009, it has become mandatory to provide nomination details at the time of opening the demat account. If the investor does not wish to make a nomination, then it has to be stated that 'I/We do not wish to make a nomination'. Nomination can be done subsequently by executing a separate Nomination Form.

Only individuals (including NRIs) can make nominations for accounts where they are the beneficial owner. A POA holder does not have the right to appoint a nominee, even if the POA provides for such an authority.

In case of joint holding, all holders need to sign the nomination. However, if one of the joint holders passes away, then ownership will go to the surviving holder/s. Only if all the joint holders pass away, the nominee is entitled to receive the assets.

Documentation requirement for nomination includes address, photograph and signature of the nominee. Two witnesses need to sign the nomination form. In the case of some assets and some institutions, only nominee name and address is adequate.

A minor cannot nominate (directly or through guardian), but can be a nominee. The documents will be required for both minor and guardian.

Non-individuals cannot nominate or be nominees. A trust, society, body corporate, partnership firm, karta of HUF or a power of attorney holder cannot be a nominee. NRI can be a nominee, subject to exchange control regulations.

Only one nominee can be appointed for a demat account. It is not possible to have separate nominees for each security in the demat account.

Nomination can be changed by executing a fresh nomination form.

On transfer of securities, the nomination shall stand terminated.

1.7 Changes in Client Information

1.7.1 Change of Address

In the case of individuals, the following documents are required:

- Application for change of address – To be signed by all holders in the case of joint holding
- Proof of address for the new address
- Proof of identity of the holder visiting the office of the intermediary with the application for address change.

Non-individuals need to comply with the following:

- Application for change, signed by authorised signatories
- Proof of address for the new address
- Proof of identity of the signatory visiting the office of the intermediary with the application for address change.

If the holder / authorised signatory cannot personally visit, then an authorised representative can visit, along with proof of identity of the representative.

After the change, intimation is to be sent to both, the new address and the old address.

1.7.2 Change in Bank Details

Application for change should be given by the signatory / signatories along with a cancelled cheque of the new bank account.

1.7.3 Change in Signatory

This normally happens for non-individuals. Application for change should be given by the signatory / signatories along with photograph and specimen signature of the new signatory.

Changes would need to be backed by Resolution of the Board of Directors / Trustees.

1.8 KYC Registration Agencies (KRA)

SEBI has simplified the account opening process for investors and made it uniform across intermediaries in the securities markets. Further, to avoid duplication of KYC process with every intermediary, SEBI has provided for a KRA system where the KYC records in the securities markets are centralised. This new system was made applicable for new clients who opened accounts with the intermediaries from January 1, 2012. Highlights of the KRA system are as follows:

- After doing the initial KYC of new clients, the intermediary has to forthwith upload the KYC information on the system of the KRA and send the KYC documents i.e. KYC application form and supporting documents of the clients to the KRA within 10 working

days from the date of execution of documents by the client and maintain the proof of dispatch.

- In case a client's KYC documents sent by the intermediary to KRA are not complete, the KRA will inform the same to the intermediary who has to forward the required information / documents promptly to KRA.
- For existing clients, the KYC data needs to be uploaded by the intermediary provided they are in conformity with details sought in the uniform KYC form.
- While uploading these clients' data the intermediary has to ensure that there is no duplication of data in the KRA system.
- The intermediary has to carry out KYC when the client chooses to trade/ invest / deal through it.
- The intermediaries have to maintain electronic records of KYCs of clients and keeping physical records is not necessary.
- The intermediary has to promptly provide KYC related information to KRA, as and when required.
- The intermediary needs to have adequate internal controls to ensure the security / authenticity of data uploaded by it.
- The operations of KRAs are governed by the following SEBI requirements:
 - o KRA system has to provide KYC information in data and image form to the intermediary.
 - o KRA has to send a letter to the client within 10 working days of the receipt of the initial/updated KYC documents from intermediary, confirming the details thereof and maintain the proof of dispatch.
 - o KRA(s) should develop systems, in co-ordination with each other, to prevent duplication of entry of KYC details of a client and to ensure uniformity in formats of uploading / modification / downloading of KYC data by the intermediary.
 - o KRA should maintain an audit trail of the upload / modifications / downloads made in the KYC data, by the intermediary in its system.
 - o KRA has to ensure that a comprehensive audit of its systems, controls, procedures, safeguards and security of information and documents is carried out annually by an independent auditor. The Audit Report along with the steps taken to rectify the deficiencies, if any, should be placed before its Board of Directors. Thereafter, the KRA has to send the Action Taken Report to SEBI within 3 months.
 - o KRA systems should clearly indicate the status of clients falling under PAN exempt categories viz. investors residing in the state of Sikkim, UN entities / multilateral

agencies exempt from paying taxes / filing tax returns in India.

- o A client can start trading / investing/ dealing with the intermediary and its group / subsidiary / holding company as soon as the initial KYC is done and other necessary information is obtained while the remaining process of KRA is in progress.
- SEBI has made In-Person Verification (IPV) mandatory for all investors who are individuals. The operating guidelines are as follows:
 - o It is mandatory for KRAs, Stock Brokers, DPs, Mutual Funds, Portfolio Managers, VCFs and Collective Investment Schemes (CIS) to carry out IPV of their individual clients.
 - o The intermediary has to ensure that the details like name of the person doing IPV, his designation, organization with his signatures and date are recorded on the KYC form at the time of IPV.
 - o The IPV carried out by one SEBI registered intermediary can be relied upon by another intermediary.
 - o In case of Stock brokers, their sub-brokers or Authorised Persons (appointed by the stock brokers after getting approval from the concerned Stock Exchanges) can perform the IPV.
 - o In case of Mutual Funds, their Asset Management Companies (AMCs) and the distributors who comply with the certification process of National Institute of Securities Market (NISM) or Association of Mutual Funds (AMFI) and have undergone the process of 'Know Your Distributor (KYD)' can perform the IPV.
 - o However, in case of applications received by the mutual funds directly from the clients (i.e. not through any distributor), they may also rely upon the IPV performed by the scheduled commercial banks.
- The KYC details of the existing clients of the intermediaries are also being uploaded in the current KRA system, in a phased manner, as follows:
 - o For existing clients who trade / invest / deal with the intermediary anytime after April 16, 2012, the intermediaries have to forthwith upload their KYC details in the KRA system. They also need to send original KYC documents to the KRA on continuous basis and complete the process within prescribed time limits.
 - o Print outs of scanned documents can be sent to the KRAs instead of original documents, certifying that the intermediary has retained the originals.
 - o The process has to be completed by March 31, 2013.
- When an existing client approaches another intermediary, it is the responsibility of that intermediary which downloads the data of that client from the KRA system, to update

the missing information, do IPV as per requirements (if not done already) and send the relevant supporting documents, if any, to the KRA. Thereafter, the KRA system will indicate the records as updated.

1.9 Suspicious Transactions Reporting (STR)

Intermediaries need to record and report specific transactions above a particular value. This includes

- All cash transactions of the value of more than Rs 10 lakh or its equivalent in foreign currency.
- All series of cash transactions integrally connected to each other which have been valued below Rs 10 lakh or its equivalent in foreign currency where such series of transactions take place within one calendar month.
- All cash transactions where forged or counterfeit currency notes or bank notes have been used as genuine and where any forgery of a valuable security has taken place.
- All suspicious transactions whether or not made in cash and including, inter-alia, credits or debits into from any non-monetary account such as demat account, security account maintained by the registered intermediary.

The suspicious transactions would include not only transactions integrally connected with each other, but also remotely connected or related.

The following is a list of circumstances which may be in the nature of suspicious transactions:

- Clients whose identity verification seems difficult or clients that appear not to cooperate
- Asset management services for clients where the source of the funds is not clear or not in keeping with clients' apparent standing /business activity;
- Clients based in high risk jurisdictions;
- Substantial increases in business without apparent cause;
- Clients transferring large sums of money to or from overseas locations with instructions for payment in cash;
- Attempted transfer of investment proceeds to apparently unrelated third parties;
- Unusual transactions by CSCs and businesses undertaken by offshore banks/financial services, businesses reported to be in the nature of export-import of small items.

Any suspicious transaction should be immediately notified to the Money Laundering Control Officer or any other designated officer within the intermediary. The notification may be done in the form of a detailed report with specific reference to the clients, transactions and the nature /reason of suspicion.

It should be ensured that there is continuity in dealing with the client as normal until told otherwise and the client should not be told of the report/suspicion.

In exceptional circumstances, consent may not be given to continue to operate the account, and transactions may be suspended, in one or more jurisdictions concerned in the transaction, or other action taken.

The Principal Officer/Money Laundering Control Officer and other appropriate compliance, risk management and related staff members should have timely access to client identification data and CDD information, transaction records and other relevant information

In some cases, transactions may have been abandoned or aborted by clients on being asked to give some details or to provide documents. Intermediaries should report all such attempted transactions in STRs, even if not completed by clients, irrespective of the amount of the transaction.

Each intermediary has to consider carefully the specific nature of its business, organizational structure, type of client and transaction, etc. to satisfy itself that the measures taken by it are adequate and appropriate and follow the spirit of the suggested measures and the requirements as laid down in the PMLA.

1.10 Designated Individuals & Entities

An updated list of individuals and entities which are subject to various sanction measures such as freezing of assets/accounts, denial of financial services etc., as approved by the Security Council Committee established pursuant to various United Nations' Security Council Resolutions can be accessed at its website at <http://www.un.org/sc/committees/1267/consolist.shtml>. Registered intermediaries are required to ensure that accounts are not opened in the name of anyone whose name appears in said list.

Registered intermediaries need to continuously scan all existing accounts to ensure that no account is held by or linked to any of the entities or individuals included in the list.

Full details of accounts bearing resemblance with any of the individuals/entities in the list should immediately be intimated to SEBI and FIU-IND.

1.11 Record Keeping

Registered Intermediaries should maintain such records as are sufficient to permit reconstruction of individual transactions (including the amounts and types of currencies involved, if any) so as to provide, if necessary, evidence for prosecution of criminal behavior.

In the case of drug related or other laundered money or terrorist property, the competent investigating authorities would need to trace through the audit trail for reconstructing a financial profile of the suspect account. To enable this reconstruction, registered intermediaries

should retain the following information for the accounts of their clients in order to maintain a satisfactory audit trail:

- The beneficial owner of the account;
- The volume of the funds flowing through the account; and
- For selected transactions:
 - o the origin of the funds;
 - o the form in which the funds were offered or withdrawn, e.g. cheques, demand drafts etc.;
 - o the identity of the person undertaking the transaction;
 - o the destination of the funds;
 - o the form of instruction and authority.

Registered Intermediaries should ensure that all client and transaction records and information are available on a timely basis to the competent investigating authorities.

Where required by the investigating authority, they should retain certain records, e.g. client identification, account files, and business correspondence, for periods which may exceed those required under the SEBI Act, Rules and Regulations framed there-under PMLA, other relevant legislations, Rules and Regulations or Exchange bye-laws or circulars.

Self-Assessment Questions

- ❖ Provisions of PMLA are applicable to
 - Banks
 - Financial Institutions
 - SEBI-regulated Intermediaries
 - **All the above**
- ❖ Which of the following is true for branches and subsidiaries of intermediaries, located abroad?
 - Comply with SEBI AML requirements to the extent local laws and regulations permit
 - In case of variance between AML requirements of India and the host country, adopt the more stringent requirements of the two.
 - **Both the above**
 - None of the above

- ❖ Which of the following is true of accounts for PEP?
 - Intermediaries not permitted to open accounts
 - **Intermediaries are required to obtain senior management approval for establishing business relationships with PEPs**
 - Intermediaries are required to obtain SEBI's consent before opening account
 - Intermediaries are required to obtain SEBI's concurrence after opening the account
- ❖ There is no minimum investment threshold/ category-wise exemption available for carrying out CDD measures by registered intermediaries.
 - **True**
 - False
- ❖ In which of the following is PAN card not required?
 - **UN entities/ multilateral agencies which are exempt from paying taxes/ filling tax returns in India**
 - Residents of Andaman & Nicobar islands
 - Both the above
 - None of the above
- ❖ Which of the following can make a nomination?
 - **Individual**
 - HUF
 - Trust
 - Individual & HUF

Chapter 2 : Primary Market

Security transactions between the issuer and investor are referred to as primary market. When securities already issued by an issuer are traded, it is a secondary market transaction.

2.1 *Types of Issues*

Different types of securities are issued in the primary market.

Multiple offering mechanisms are available for each of these securities:

2.1.1 *Public Issue - IPO*

When equity shares are issued to the public for the first time, it is called Initial Public Offer (IPO). The culmination of an IPO is the listing of those shares in a stock exchange. Thereafter, equity shares of the company can be bought and sold in the stock exchange.

The various steps that are part of the IPO process are discussed in the next section.

2.1.2 *Public Issue – Follow-on Offering*

Public issue of equity shares by a listed company is called a Follow-on Public Offer. A company will have only one IPO, but it can make several FPOs.

In a FPO, equity shares are offered to investors other than those who are currently invested in the company. This will bring down the share-holding percentage of existing investors. For example, if an existing investor holds 1% of the equity share capital of the company, it will become 0.5% if the company's equity share capital is doubled through a follow-on offering to other investors. This is called "dilution of shareholding".

Section 81 of the Companies Act provides a right to existing share-holders to protect themselves against such dilution. The company proposing to issue equity shares to other investors will need a special resolution to that effect, passed in a general meeting of the company. For a special resolution, the number of votes in favour of the resolution needs to be at least three times the number of votes against (i.e. three fourths majority is required).

2.1.3 *Public Issue – Offer for Sale*

The shares that investors receive in a public issue, may either be new shares issued by the company, or previously issued shares sold by the current investors as part of the public offer (or a mix of both). When current investors sell part or whole of their shareholding as part of a public issue, it is called 'Offer for Sale'. The offer for sale can be part of IPO or follow-on public offering.

2.1.4 *Rights Issue*

When securities are issued to current investors in proportion to their share-holding in the company, it is called a rights issue. The proportion that each investor is entitled to, is called

the rights ratio. For example, 1:2 Rights means that current investors will get 1 share for every 2 shares held by them in the company.

The rights price is announced when the issue is made. Investors who wish to exercise their rights will need to pay the rights price to acquire the shares they are entitled to.

In some rights issues, the rights-holder is entitled to renounce the right in favour of other investors. The renouncee will buy those rights from the existing investor, and subscribe to shares of the company by paying the rights price. This makes it possible for the existing investor to earn some profit out of the rights issue, without subscribing to the new shares offered.

2.1.5 Bonus Issue

Like a rights issue, bonus issue too leads to issue of new shares and increase in share capital. The bonus ratio determines the number of new shares that will be issued to existing investors for every share they hold in the company.

Unlike a rights issue, in a bonus issue the investor does not pay anything for the new shares issued. The company issues the bonus shares by capitalizing its reserves, i.e. transferring the required amount from its reserves to the share capital of the company.

Bonus issue is different from a stock split. New shares are issued to investors, without their having to pay for them, even through a stock split. Suppose a company has issued 100,000 shares of Rs. 10 each. Its share capital would therefore be 100,000 shares X Rs. 10 per share i.e. Rs. 10,00,000. If it chooses to split its shares into face value of Rs. 2 per share, then the share capital of the company remains the same at Rs. 10,00,000. However, it will be represented by 500,000 shares of Rs. 2 each. Investors will be given 5 shares of Rs. 2 each, for every share of Rs. 10 that they hold.

2.1.6 Private Placement

Private placement is an offer of securities, directly made to select set of investors (upto 49 investors can participate in a private placement).

Private placement is the preferred mode of offer for most securities other than equity shares. Even equity shares are issued through private placement during the initial stages of a company.

Listed companies may offer shares on a private placement basis to promoters, foreign collaborators, business partners etc. This is called preferential allotment. The shares will be locked-in (i.e. cannot be sold) for three years from the date of allotment, in case of promoters. The lock-in period is one year for preferential allotment to non-promoters.

Another format for private placement by listed companies is Qualified Institutional Placement (QIP). SEBI recognises the following as Qualified Institutional Buyers (QIBs):

- Public financial institution as defined in section 4A of the Companies Act, 1956;
- Scheduled commercial banks;
- Mutual funds;
- Foreign institutional investor registered with SEBI;
- Multilateral and bilateral development financial institutions;
- Venture capital funds registered with SEBI;
- Foreign Venture capital investors registered with SEBI;
- State Industrial Development Corporations;
- Insurance Companies registered with the Insurance Regulatory and Development Authority (IRDA);
- Provident Funds with minimum corpus of Rs. 25 crores;
- Pension Funds with minimum corpus of Rs. 25 crores).

QIP can be made in favour of QIBs. At least two QIB allottees are required for issue size upto Rs. 250 crore. Higher issue sizes call for five QIB allottees. No QIB can be allotted more than 50% of the issue size. Promoters cannot invest as QIBs.

Even private placements by listed companies need to comply with SEBI guidelines. However, private placements by private companies are beyond the purview of SEBI.

Private placements are cheaper and faster than public issues, even when the private placement is subject to SEBI guidelines. This has made it a preferred mode of issue for many companies.

There is no requirement of filing any offer document / notice to SEBI in case of preferential allotment and QIP. In QIP, Merchant Banker handling the issue has to file copy of placement document with SEBI post allotment for record purpose.

2.1.7 GDR / ADR Issues

Foreign investors investing in the Indian stock market need to comply with various regulations of SEBI and RBI. Further, their investments are settled through the Indian stock exchange settlement system, where receipts and payments are made in Indian rupees.

Global Depository Receipts (GDR) / American Depository Receipts (ADR) are issued to international investors and are listed in international stock exchanges. ADRs are listed in stock exchanges in the US; GDRs are listed in other exchanges abroad.

Each GDR / ADR represents a certain number of underlying equity shares in a company. Therefore, while it derives its value from the Indian company's share, the international investor can buy and sell them in international exchanges without foreign currency conversion of investment or sales realisation. The process is split into the following critical steps:

- The company receives subscriptions from the investor
- The company issues the shares to a depository
- The depository issues the GDR / ADR to the investors who invested in the GDR / ADR issue.

2.1.8 *Sponsored GDR / ADR Issues*

In a regular GDR / ADR issue, the company issues the shares against which the GDR / ADR is issued. Thus, the proceeds of the GDR / ADR come into the company. The share capital and reserves of the company go up.

A sponsored ADR / GDR issue is made when the company does not need funds and does not wish to increase its share capital. Sponsored GDR / ADR is issued against the shares of existing resident investors.

Through a sponsored issue, the company makes an offer to resident investors to surrender their shares. Against the surrendered shares, it issues ADR / GDR. The process is split into the following stages:

- Generally, a special purpose trust is created through which the investor's shares are transferred.
- Offer is made to resident investors to indicate their interest in surrendering their shares for the purpose of the sponsored issue.
- If the interest in surrendering the shares is more than the size of the proposed issue, then pro-rata allocation is made.
- Based on the allocation, investor's shares are transferred to the trust.
- The trust receives money from the investors in the sponsored ADR / GDR issue.
- The trust transfers the shares to a depository.
- The depository issues the GDR / ADR shares to the investors who invested in the GDR / ADR issue.
- The money received from investors in the sponsored issue, after adjusting for expenses, is distributed to resident investors as per their allocation.

2.1.9 *Foreign Currency Convertible Bond (FCCB) Issues*

FCCBs are denominated in foreign currency. Depending on the terms of the issue, conversion into equity shares is either compulsory or optional. Many FCCBs issued by Indian companies are convertible at the option of the investor. Conversion can be at a fixed price, or linked to the market price of the shares at the time of conversion.

Until conversion, interest is payable, either at a fixed rate or on a floating rate basis.

FCCBs are generally offered on private placement basis to international investors.

2.1.10 India Depository Receipts

IDRs are issued by foreign companies that wish to attract Indian capital. The steps involved are similar to a public issue. However, investors are given IDRs instead of shares. Based on subscription from investors, the issuing company will issue shares to a depository. The depository in turn will offer IDRs to the investors.

2.2 Public Issue Process

Public Issues are covered by the Securities & Exchange Board of India (Issue of Capital & Disclosure Requirements) Regulations, 2009.

Companies appoint *investment bankers* (earlier called *merchant bankers*) to assist them in the IPO process. The investment banker works with the company over several months, preparing the company for the IPO and then handling the IPO. The responsibilities include conducting the due diligence on various disclosures in the prospectus, liaise with SEBI and co-ordinate on all other aspects of the issue.

It is quite common to have a team of investment bankers as *issue managers*, especially for large issues. The issue managers sign an *inter se* agreement that sets out each investment banker's role and responsibility. Among them, one is the lead – also called *Book Running Lead Manager* in book-built issues (where issue price is decided based on investor response). Others are *co-Leads*, and may also be called *Book Running Lead Managers*.

Besides the investment banker, some other agencies are appointed by the company. These are:

- *Syndicate Members* – Brokers registered with SEBI are appointed to procure bids (applications) from investors for the IPO.
- *Sub-syndicate Members* - They work under syndicate members to procure bids from investors.
- *Underwriters* – Investment Bankers, stock brokers and other SEBI-registered underwriters are appointed to ensure that the issue amount is mobilized.

Each underwriter indicates an amount that he is underwriting. If the issue does not receive adequate subscriptions from investors, then the shortfall is to be met by the underwriters (who have brought in fewer applications than the amount underwritten by them).

- *Legal adviser* – Solicitors, to advise on all legal aspects of the issue, to ensure that all legalities are complied with and to review the Prospectus of the issue
- *Credit Rating Agency* – to grade the IPO.

An independent and unbiased grading of the IPO is compulsory.

- *Depository* – to demat the shares of the company.

It is compulsory for companies coming out with a public issue to offer demat facility.

- *Registrar & Transfer Agent (RTA)* – to process investors' applications and handle the allotment and refunds

The company, Depository and RTA enter into a tripartite agreement for their respective responsibilities.

It is pertinent to note that while the RTA operationalizes the allotment (based on which investors know how many shares they have been allotted), the relevant shares will need to be dematerialized with the depository, who will credit the demat shares to the investors' account (maintained with a depository participant).

- *Bankers to the issue* – to collect forms and relevant payment instruments
- *Self-certified Syndicate banks* – These are banks that offer the facility of accepting Applications Supported by Blocked Amounts (ASBA) applications. ASBA is discussed in greater detail later in this Chapter.

Some of the stages that are part of the IPO process are as follows:

- Deciding on the Resource Mobilisation Program, Capital Structure, Business Valuation and Dilution Level. This is a key area where the investment banker advises the company and its promoters. Some of the dynamics involved are:
 - o The resources mobilized should be adequate for the company's medium term plans.
 - o Capital structure needs to be appropriate for the company, given its business exigencies, risks and long term plans.
 - o Higher the business valuation, lesser would be the dilution required for meeting the resource mobilization target.

For example, if the company is valued at Rs. 2,000 crore, and it wants to come to the market for Rs. 200 crores, then only about 10% of the share capital needs to be offered to the public. But, for the same requirement of funds, if the business valuation is only Rs. 1,000 crore, then about 20% of the share capital will need to be offered to the public.

Higher the dilution, lesser the equity control that the promoter would have over the company.

- o Higher the business valuation, lesser the profits that investors in the IPO will earn, when they sell their shares in the stock exchange. Therefore, too high a business valuation would make it difficult for the investment banker to sell the issue.

- SEBI has laid down strict regulations regarding eligibility of companies to tap the IPO market and preferential allotments. Similarly, there are various requirements that the company has to fulfil on an ongoing basis, once its shares are listed.

The investment banker hand-holds the company over several months in order to ensure that the company can stand the public scrutiny that is incidental to the IPO process and listing.

- As regards pricing, two options are available:
 - o *Fixed price issue* – here the investor knows at the time of investment, the exact price at which the shares are being offered. So the investor only indicates the number of shares in his application.

If the applications for shares are more than the issue size, then a basis of allotment is decided in consultation with the stock exchange. Accordingly, the investor may be allotted all the shares he applied for, or some of the shares he applied for, or none of the shares he applied for.

- o *Book built issue* – here the investors know a *price band*, say Rs100 to Rs120, at the time of investment. The lower end of the band is called *floor*; the higher end is the *cap*. The cap cannot be more than 1.2 times the floor.

Within this price band, investors have to bid for the shares i.e. indicate the number of shares that they are prepared to buy at various prices.

The issue book is built as a compilation of such bids received from investors. Depending on the depth of bids received, the investment banker together with the company will decide the *cut-off price*. The process is called *price discovery process*.

All bids to buy the shares below the cut-off price are rejected. Allotment for other bids is done as per a basis of allotment that is finalized along with the stock exchange.

- The prospectus is a key document that has details of the company, its background, promoters, directors and management, company's financials, plans, objects of the issue etc. The prospectus is prepared by the lead manager and reviewed by the legal adviser before it is submitted to SEBI for vetting.
- In a book-built issue, the prospectus evolves through three forms:
 - o *Draft Red Herring Prospectus (DRHP)* – This has all the statutory details other than the price of the issue and issue period. It is submitted to SEBI for vetting
 - o *Red Herring Prospectus (RHP)* – The price band and the issue period are added to the prospectus that has been vetted by SEBI. This is submitted to the ROC.

- o *Prospectus* – The final price (instead of price band) is incorporated in the RHP after the issue is closed and price discovery process is completed.
- The company also needs to sign a listing agreement with the stock exchanges where it proposes to list its shares. The exchanges where it proposes to list are mentioned in the Prospectus.
- Around the issue opening date, the investment bankers arrange conferences for brokers and the press. The conferences are not only publicity events, but also a forum for the brokers / press to meet the company's management and seek clarifications on their plans.
- Based on the advertising and publicity campaign, and the efforts of syndicate members, investors apply in the IPO. Applications / bids are accepted until the issue closure date.
- Applications are tabulated by the RTA, who also reconciles the balances with the bankers to the issue.
- If the issue is not fully subscribed, and it is underwritten, then the RTA generates the list of underwriting commitments made, subscriptions procured and devolvment on each underwriter.
- The company and the lead managers decide on the allotment price. The basis of allotment is decided in consultation with the lead stock exchange.
- The RTA operationalizes the allotment, based on the basis finalized with the stock exchange.

For this purpose, RTA generates the following information:

- o Basis of allotment
- o Top 100 applications
- o Certificate of final collection from the bankers and reconciliation statement
- o List of applications rejected on technical grounds
- o Minutes of the meeting held with the issuer, lead manager/book running lead manager and stock exchange for finalizing the basis of allotment

The allotment scheme mandated by SEBI provides for specific allocation in the scheme for the category of resident individual investors who invest upto Rs. 200,000 in the issue.

- Accordingly,
 - o A list of allottees and the number of shares allotted to each, is prepared and sent to the depository, who credits the shares to each allottee's demat account with his respective depository participant.

- o For applications made under ASBA (discussed later in the Chapter), the registrar processes requests for banks to release blocked amounts as per the allotments made on those applications.
- o For other applications where partial allotments are made, the registrar processes refund instructions.
- The lead manager intimates SEBI and the Stock Exchanges regarding completion of the various formalities.
- Public notice is issued regarding the allotment
- The stock exchange sets a date for commencement of trading. The first day of trading has become a ceremonial affair, where the company's management or any of its brand ambassadors *rings the opening bell* in the exchange. With this, trading in the company's shares commences.
- The RTA prepares the list of commission payable to market intermediaries for procuring the applications.

The back office processes are largely similar for FPOs.

2.3 Time-line for Public Issue

Annexure B to SEBI's Circular CIR/CFD/DIL/1/2011dt. April 29, 2011 gives an indicative time line for the public issue process as follows:

Sl. No.	Details of Activities		Time-line
	<i>Non-ASBA</i>	<i>ASBA through Syndicate Member</i>	
1	Investor submits a completed bid cum application form to Syndicate /Sub-Syndicate Member, who shall upload bid details in the electronic bidding system of stock exchange(s). Syndicate members need to ensure that required documents are attached with the application form.	Investor submits a completed bid cum application form indicating the mode of payment option as ASBA to Syndicate Member. Syndicate Member shall give an acknowledgement by giving the counter foil as proof of having accepted his/ her application. Syndicate Member shall upload bid details in the electronic bidding system of stock exchange(s).	Issue opening date to issue closing date (where T is issue closing date)
2	Issue Closes		T

Sl. No.	Details of Activities		Time-line
	Non-ASBA	ASBA through Syndicate Member	
3	<p>Stock exchange(s) to allow syndicate members to undertake modification of select fields in the bid details already uploaded.</p> <p>Registrar to get the electronic bid details from the stock exchanges at the end of the day.</p>		T+1
4	<p>Issuer, merchant banker and registrar to submit relevant documents to the stock exchange(s) except listing application, allotment details and demat credit and refund details for the purpose of listing permission.</p> <p>Syndicate members to forward a schedule(containing application number, payment instrument number and amount),application forms and payment instruments to collecting banks.</p> <p>Collecting banks may not accept bid schedule, bid applications and payment instrument after T+2 day.</p> <p>Registrar to give bid file received from the stock exchanges containing the application number and amount to all the collecting banks who can use this file for validation at their end.</p> <p>Registrar to commence validation of the electronic bid details with depositories records for DP ID, Client ID and PAN.</p>	<p>Syndicate members to forward a schedule (containing application number and amount) along with application forms to the branch named for 'Syndicate ASBA' of the respective SCSBs for blocking of Fund.</p> <p>Designated branches may not accept schedule and applications after T+2 day.</p> <p>Registrar to give bid file received from the stock exchanges containing the application number and amount to respective SCSBs duly sorted centre wise who may use this file for reconciliation.</p> <p>SCSBs to start blocking funds.</p>	T+2
5	<p>Registrar to continue validation of the electronic bid details with depositories records.</p> <p>Collecting banks to commence clearing of payment instruments.</p>	Blocking funds continues	T+3

Sl. No.	Details of Activities		Time-line
	<i>Non-ASBA</i>	<i>ASBA through Syndicate Member</i>	
6	Registrar to complete validation of the electronic bid details with depositories records. Collecting banks to start forwarding application form along with bank schedules to registrar.	SCSBs to start forwarding application forms along with bank schedules to registrar.	T+4
7	Registrar to prepare list of rejected bids based on mis-match between electronic bid details and depositories data base. Registrar to undertake "Technical Rejection" test based on electronic bid details and prepare list of technical rejection cases.		T+5
8	Collecting banks to submit status of clearance status of payment instrument i.e. "Final Certificate" to the registrar.	SCSBs to submit status of blocking of fund i.e. "Final Certificate" to the registrar.	T+6
9	Collecting banks/SCSBs to ensure that all application forms are forwarded to the registrar. Registrar to undertake and complete reconciliation of final certificate received from the collecting banks with electronic bid details. Registrar submits the final basis of allotment to Designated Stock Exchange(s) for approving the basis of allotment.		T+7
10	Designated stock exchange(s) to approve the basis of allotment. Registrar to prepare funds transfer schedule based on approved allotment. Registrar to give instructions to depositories to carry out lock-in for pre issue capital.		T+8
11	Registrar and merchant banker to issue funds transfer instructions to collecting banks/SCSBs. Collecting banks/SCSBs to credit the funds in Public Issue Account of the issuer and confirm the same. Issuer to make allotment. Registrar to give instruction to depositories for credit of shares to successful allottees. Registrar to receive confirmation for pre-issue capital lock-in from depositories.		T+9

Sl. No.	Details of Activities		Time-line
	Non-ASBA	ASBA through Syndicate Member	
12	<p>Issuer and registrar to file allotment details with designated stock exchange(s) and confirm all formalities are completed except demat credit and refund.</p> <p>Registrar to complete refund dispatch.</p> <p>Registrar to issue bank-wise data of allottees, allotted amount and refund amount to collecting banks/SCSBs.</p>		T+10
13	<p>Registrar to receive confirmation of demat credit from depositories and submit the same to the stock exchange(s).</p> <p>Issuer and registrar to file confirmation of demat credit and refund dispatch with stock exchange(s).</p> <p>Issuer to make a listing application to stock exchange(s) and stock exchanges to give listing and trading permission.</p> <p>Issuer, merchant banker and registrar to publish allotment advertisement before the commencement of trading, prominently displaying the date of commencement of trading, in all the newspapers where issue opening/closing advertisements have appeared earlier.</p> <p>Stock exchange(s) to issue commencement trading notice.</p>		T+11
14	Trading commences		T+12

2.4 Common Bid-cum-Application Form

A single form is applicable for both ASBA and non-ASBA applications. The format mandated by SEBI is given in Appendix 2.1.

The colour of the form is standardized as follows:

- White form for Resident Indians and Eligible NRIs applying on a non-repatriation basis
- Blue form for Eligible NRIs, FVCIs, FIIs, their Sub-Accounts (other than Sub-Accounts which are foreign corporates or foreign individuals bidding under the QIB Portion), on a repatriation basis

Signature of only the first bidder is required. First bidder is deemed to have signed on behalf of joint holders and give requisite confirmation(s) to that effect.

Provision for stamp of broker/SCSB Branch has been made in the main application form. The stamping is to be done only after bid has been uploaded.

2.5 ASBA

ASBA enables investors to apply for IPOs / FPOs and rights issues without making a payment. Instead, the amount is blocked in the investors' own bank account. On allotment, an amount proportionate to the shares allotted goes out from the bank account; the balance amount is unblocked and available for use by the investor. Thus, the investor is saved the head ache of waiting for refund of moneys after allotment.

An ASBA investor has to submit an ASBA, physically or electronically through the internet banking facility, to the SCSB with whom, the bank account to be blocked, is maintained.

The SCSB shall then block the application money in the bank account specified in the ASBA, on the basis of an authorisation to this effect given by the account holder in the ASBA. The application money shall remain blocked in the bank account till finalisation of the basis of allotment of the issue or till withdrawal/ failure of the issue or till withdrawal/ rejection of the application, as the case may be.

The application data shall thereafter be uploaded by the SCSB in the electronic bidding system through a web enabled interface provided by the Stock Exchanges.

Once the basis of allotment is finalized, the Registrar to the Issue shall send an appropriate request to the controlling branch of SCSB for unblocking the relevant bank accounts and for transferring the requisite amount to the issuer's account designated for this purpose. In case of withdrawal/ failure of the issue, the amount shall be unblocked by the SCSB on receipt of information from the pre-issue merchant bankers through the concerned Registrar to the Issue.

ASBA facility in rights issue enables a shareholder of the company as on record date to apply through ASBA mode by selecting the option of ASBA either (i) in Part A of the application form of rights issue, or (ii) in the plain paper application as to whether they desire to avail of the ASBA option, to the Self Certified Syndicate Bank (SCSB) with whom the bank account to be blocked, is maintained.

The ASBA process from the time of submission of application by the applicants till transfer of shares in the depository account of the investors, as specified for public issues, are followed in the case of rights issues also to the extent relevant for rights issue. The role and responsibilities of SCSB, stock exchanges, registrars and merchant bankers for rights issues too are similar to public issue.

Through syndicate / sub-syndicate members, ASBA facility is initially to be offered at the following locations:

- i. Mumbai
- ii. Chennai
- iii. Kolkata

- iv. Delhi
- v. Ahmedabad
- vi. Rajkot
- vii. Jaipur
- viii. Bangalore
- ix. Hyderabad
- x. Pune
- xi. Baroda
- xii. Surat

All the SCSBs which are providing ASBA facility in any of the above mentioned centers are required to name atleast one branch where syndicate / sub-syndicate members can submit the ASBA forms.

2.6 Buy Back of Securities

In a buy back, the company buys back some shares from investors. It is governed by the SEBI (Buy Back of Securities) Regulations, 1998.

The approval requirement depends on the level of shares proposed to be bought back as follows:

- Only board approval is required, if only 10% of the share capital and free reserves are proposed to be used for the buyback.
- Special resolution of shareholders is required, if it is between 10% and 25%.
- Buyback beyond 25% of the share capital and free reserves is not permitted.

The buy back may be done for one or more of the following reasons:

- Support the share price in the market

If the share price goes below what the management believes to be its intrinsic worth, the company may offer to buy back its shares. The price at which it indicates its willingness to buy back the shares, become the floor price at which shares are traded in the market.

- Increase promoters' stake

Suppose promoters hold 45% of the shares in a company. If a company buys back shares from non-promoters to the extent of 10%, and cancels them, then the revised promoter stake would be $45\% \div 90\%$ i.e. 50%. Thus, promoters are able to raise their stake in the company.

In the normal course, promoters need to pay money to raise their stake. In the case of buy back, promoters are able to increase their stake though it is the company which uses its funds for the buy back.

- Increase Earnings per Share (EPS) and future Dividends per Share (DPS)

When the shares are bought back and cancelled, the number of equity shares issued by the company. Depending on the price at which the shares are bought back, the EPS of the share can go up, leading to higher DPS in future. These factors will drive up the share price in the market. Thus, investors who do not offer their shares in the buy back process benefit too.

- Improve return on equity

The company may have idle cash that it cannot put to productive use. This can bring the return on equity ratios of the company. Through a buy back of the shares, the surplus cash is used and the company's return on equity can improve. This will improve the valuation of the company's shares in the market.

- Protection from takeover

At times, companies are taken over because they are available cheap or the company has idle cash which the predator may like to use. As discussed above, in a buy back, the company uses its cash reserves and the company's share valuation can improve. This makes it unattractive for the predator to takeover the company. Thus, buy back becomes a defensive move by the current owners / management of the company.

Some of the processes involved in a buyback are as follows:

- Intimation to SEBI and the stock exchanges where the shares are listed.
- Public notice to investors, including details of reasons for the buy back, the total number and percentage of the shares and the price at which they are being bought back, the process and funding of the buy back, the specified date and the timetable of the buyback
- The company has to open an escrow account on or before the opening of the offer. Deposit would need to be to the extent of 25% for buy back upto Rs. 100 crores; 10% on excess over Rs. 100 crores.

Alternatively bank guarantees or securities for that amount can be deposited with the merchant banker.

- The securities can be bought back through any of the following routes:

- o Tender offer to existing shareholders for buy back

- Draft Letter of Offer has to be submitted to SEBI.
- The Letter of Offer is sent to investors.
- Offer will be open for 15 to 30 days
- If offers from shareholders exceed the limit, then they will be accepted on proportionate basis.

- Within 7 days of the closure of the issue, shareholders will need to be paid or their shares returned.
- The shares bought back are cancelled.
- Certificate is to be sent to SEBI and the stock exchanges, signed by the RTA, auditor and directors of the company.
- o Purchase from market through the stock exchange
 - Public notice has to be given, mentioning the broker and stock exchange through which the buy back will be effected.
 - Stock exchange has to be informed daily about the shares bought back.
 - Every time 5% of the buyback is completed, notice has to be given in a national daily.
 - The shares bought back are cancelled.
 - Certificate is to be sent to SEBI and the stock exchanges, signed by the RTA, auditor and directors of the company.
- o Purchase through book building process
 - The company appoints a merchant banker for the exercise.
 - Public notice has to be given.
 - Bids should be entertained through an electronic facility with at least 30 bidding centres.
 - Offer will be open for 15 to 30 days
 - The shares bought back are cancelled.
 - Certificate is to be sent to SEBI and the stock exchanges, signed by the RTA, auditor and directors of the company.
- o Purchase from odd lot share holdings
 - Letter is sent to the odd lot shareholders
 - Shares of those who offer their shares for buyback are bought back and cancelled.
 - Certificate is to be sent to SEBI and the stock exchanges, signed by the RTA, auditor and directors of the company.

Common Bid Cum Application Form for ASBA / Non-ASBA

COMMON BID CUM APPLICATION FORM FOR ASBA / NON-ASBA		XYZ LIMITED - PUBLIC ISSUE - R		FOR RESIDENT INDIAN, QIB, ELIGIBLE NRI'S APPLYING ON A NON-REPATRIATION BASIS	
Logo To, The Board of Directors XYZ Limited		BOOK BUILDING ISSUE IN		Bid cum Application Form No.	
SYNDICATE MEMBER'S STAMP & CODE		BROKER'S/AGENT'S STAMP & CODE		1. NAME & CONTACT DETAILS of Sole / First Applicant	
ESCROW BANK / SCSB BRANCH STAMP & CODE		SUB-BROKER'S/SUB-AGENT'S STAMP & CODE		Mr. / Ms. _____	
BANK BRANCH SERIAL NO.		REGISTRAR'S / SCSB SERIAL NO.		Address _____	
				Email _____	
				Tel. No (with STD code) / Mobile _____	
				2. PAN OF SOLE / FIRST APPLICANT	
3. BIDDER'S DEPOSITORY ACCOUNT DETAILS <input type="checkbox"/> NSDL <input type="checkbox"/> CDSL				6. Investor Status	
For NSDL enter 8 digit DP ID followed by 8 digit Client ID / For CDSL enter 16 digit Client ID				<input type="checkbox"/> Individual(s) - IND <input type="checkbox"/> Hindu Undivided Family* - HUF <input type="checkbox"/> Bodies Corporate - CO <input type="checkbox"/> Banks & Financial Institutions - FI <input type="checkbox"/> Mutual Funds - MF <input type="checkbox"/> Non-Resident Indians - NRI (Non-Repatriation basis) <input type="checkbox"/> National Investment Fund - NIF <input type="checkbox"/> Insurance Funds - IF <input type="checkbox"/> Insurance Companies - IC <input type="checkbox"/> Venture Capital Funds - VC <input type="checkbox"/> Others (Please specify) - OTH	
4. BID OPTIONS (Only Retail Individual Bidders can Bid at "Cut-off")				5. Category	
Bid Options	No. of Equity Shares Bid (In Figures) (Bids must be in multiples of Bid Lot as advertised)	Price per Equity Share (₹) / "Cut-off" (Price in multiples of ₹ 1/- only) (In Figures)		<input type="checkbox"/> Retail Individual <input type="checkbox"/> Non-Institutional <input type="checkbox"/> QIB	
		Bid Price	Discount, if any	Net Price	"Cut-off" (Please tick)
Option 1	7 6 5 4 3 2 1	4 3 2 1	4 3 2 1	4 3 2 1	<input type="checkbox"/>
(OR) Option 2	7 6 5 4 3 2 1	4 3 2 1	4 3 2 1	4 3 2 1	<input type="checkbox"/>
(OR) Option 3	7 6 5 4 3 2 1	4 3 2 1	4 3 2 1	4 3 2 1	<input type="checkbox"/>
7. PAYMENT DETAILS (Please tick (✓) any one of payment option A or B below)				PAYMENT OPTIONS <input type="checkbox"/> Full Payment <input type="checkbox"/> Part Payment	
Amount Paid (₹ in figures) _____ (₹ in words) _____					
<input type="checkbox"/> (A) CHEQUE/ DEMAND DRAFT (DD) Cheque/DD No. _____ Dated <u>DD</u> / <u>MM</u> / <u>YY</u> Drawn on (Bank Name & Branch) _____				<input type="checkbox"/> (B) ASBA Bank A/c No. _____ Bank Name & Branch _____	
I/WE (ON BEHALF OF JOINT APPLICANTS, IF ANY) HEREBY CONFIRM THAT I/WE HAVE READ AND UNDERSTOOD THE TERMS AND CONDITIONS OF THIS BID CUM APPLICATION FORM AND THE ATTACHED FORM 2A AND HEREBY AGREE AND CONFIRM THE BIDDERS UNDERTAKING AS GIVEN OVERLEAF. I/We (on behalf of joint applicants, if any) hereby confirm that I/We have read the Instructions for Filling up the Bid Cum Application Form given overleaf.					
8A. SIGNATURE OF SOLE / FIRST APPLICANT		8B. SIGNATURE OF ASBA BANK ACCOUNT HOLDER(S) (AS PER BANK RECORDS) (For ASBA option ONLY)		BROKER'S / SCSB BRANCH'S STAMP (Acknowledging upload of Bid in Stock Exchange system)	
Date: _____, 2011		I/We authorize the SCSB to do all acts as are necessary to make the Application in the issue		1)	
				2)	
				3)	
TEAR HERE					
XYZ LIMITED		Acknowledgement Slip for Syndicate Member / SCSB		Bid cum Application Form No.	
DPID / CLID		PAN		Stamp & Signature of Banker	
Amount Paid (₹ in figures)		Bank & Branch		Received from Mr./Ms.	
Cheque / DD/ASBA Bank A/c No.		Telephone / Mobile		Email	
TEAR HERE					
XYZ LIMITED		Stamp & Signature of Syndicate Member / SCSB		Name of Sole / First Applicant	
No. of Equity Shares		Option 1		Option 2	
Bid Price		Option 3		Option 4	
Amount Paid (₹)		Option 5		Option 6	
Cheque / DD/ASBA Bank A/c No.		Option 7		Option 8	
Bank & Branch		Option 9		Option 10	
Acknowledgement Slip for Bidder					
Bid cum Application Form No.					

IN THE NATURE OF ABRIDGED PROSPECTUS - MEMORANDUM CONTAINING SALIENT FEATURES OF THE RED HERRING PROSPECTUS (RHP)

BIDDER'S UNDERTAKING FOR BID CUM APPLICATION FORM

(IN CASE OF A JOINT APPLICATION, THE CONFIRMATIONS, AUTHORIZATIONS, UNDERTAKINGS AND REPRESENTATIONS MADE BY THE FIRST APPLICANT WILL BE DEEMED TO HAVE BEEN MADE ON BEHALF OF ALL JOINT APPLICANTS. THE FIRST APPLICANT SHALL BE LIABLE FOR ALL THE OBLIGATIONS ARISING OUT OF THE ISSUE OF EQUITY SHARES.)

On the basis of the RHP dated 2011 and having studied the attached details as per the Memorandum in the nature of Form 2A, I/we hereby apply for allotment to me/us of the Equity Shares in the Issue upto my/our Bid for maximum number of Equity Shares at or above the Issue Price, net of discount, if any, to be discovered through book building. I/we hereby confirm that I am/we are eligible persons to invest in this Issue in accordance with applicable laws. The amount payable on bidding, net of discount, if any, is remitted herewith. I/we agree to accept the Equity Shares Bid for, or such lesser number as may be allotted to me/us subject to the terms of the RHP, the Bid cum Application Form and other applicable laws. I/we undertake that I/we will sign all such other documents and do all such acts, if any, necessary on my/our part to enable me/us to be registered as the holder(s) of the Equity Shares which may be allotted to me/us. I/we authorize you to place my/our name on the register of members of the Company as holders of the Equity Shares that may be allocated / allotted and to register my/our address as given in the depository records. I/we note that in case of QIB Bidders, only the BRLMs, and their affiliates may reject Bids at the time of acceptance of Bid cum Application Form provided that the reasons for rejecting the same shall be provided to such Bidder in writing, whereas it has a right to reject it from Non-Institutional Bidders and Retail Individual Bidders based only on technical grounds and/or as specified in the Abridged Prospectus and the RHP. I/we authorize the Company to make the necessary changes in this Bid cum Application Form and the RHP for filing of Prospectus with the Registrar of Companies without intimation to me/us and use this Bid Form as the Application Form for the purpose of this Issue. I/WE CONFIRM THAT: EITHER I am/We are Indian National(s) resident in India and I am/we are not applying for the said Equity Shares as nominees of any person resident outside India or Foreign Nationals OR I am/We are Indian National(s) resident in India and I am/we are applying for the said Equity Shares as Power of Attorney holder(s) of Non-Resident Indian(s) as mentioned on Non-Repatriation basis OR I am/We are Indian National(s) resident outside India and I am/we are applying for the said Equity Shares on my/our own behalf through NRO account on Non-Repatriation basis. I am/we are, or at the time the Equity Shares are purchased will be, the beneficial owner of such shares and (a) I/we and any customer I/we represent, am/are located outside the United States within the meaning of Regulation S under the United States Securities Act of 1933, as amended, and (b) am/are not an affiliate of the Company or a person acting on behalf of such affiliate. FOR QIB BIDDERS: We confirm that the Bid Size/Maximum Equity Shares applied for by us do not exceed the relevant regulatory approvals/limits. I/we am/are not prohibited from accessing capital markets under any order/ ruling/ judgment of any regulatory, judicial or any other authority including SEBI or under the provisions of any law, regulation or statute.

In case of ASBA Bidders in addition: 1) I/we hereby undertake that I/we am/are an ASBA Bidder(s) as per the applicable provisions of the SEBI Regulations 2) In accordance with ASBA process provided in SEBI Regulations and as disclosed in the RHP, I/we authorize (a) the SCSB to do all acts as are necessary to make the Application in the Issue, including uploading my/our Bid, blocking or unblocking of funds in the bank account maintained with the SCSB as specified in the Bid Cum Application Form, transfer of funds to the Public Issue Account on receipt of instruction from Registrar to the Issue, after finalization of basis of Allotment; and (b) the Registrar to the Issue to issue instruction to the SCSBs to remove the block on the funds in the specified bank account upon finalization of the basis of Allotment. 3) In case the amount available in the specified bank account is insufficient as per the highest Bid option, net of discount, if any, the SCSB shall reject the Application. 4) I/we hereby authorize the SCSB to make relevant revisions as may be required to be done in the Bid, in the event of a price revision

INSTRUCTIONS FOR FILLING UP THE BID CUM APPLICATION FORM

- Name of Sole/ First Applicant should be exactly the same as it appears in the depository records.
- Except for Bids by persons resident in the state of Sikkim, or on behalf of the Central or State Government and the officials appointed by the courts, the Bidder, or in the case of a Bid in joint names, the first Bidder, should mention his/ her PAN allotted under the Income Tax Act, and any Bid cum Application Form without the PAN is liable to be rejected.
- Based on the PAN, DP ID and Client ID provided by the Applicants, the Registrar will obtain demographic details registered with depository participants to be used for allotment, technical rejections, giving refunds or unblocking of ASBA Account. Hence, Bidders are advised to immediately update any change in their details as appearing on the records of the Depository Participant. Please note that failure to do so could result in failure in allotment of Equity Shares, delays in despatch/ credit of refunds to Bidders or unblocking of ASBA Account at the Bidders sole risk and neither the BRLMs or the Registrar or the Escrow Collection Banks or the SCSBs nor the Company shall have any responsibility and undertake any liability for the same.
- Bid Lot and Price Band:** The price band, discount offered, if any, and the minimum bid lot will be decided by the Company in consultation with the BRLMs and will be advertised at least two working days prior to the Bid/Issue Opening Date, in English national daily, Hindi national daily and regional language news paper each with wide circulation. In case of revision of the Price Band, the Bid/ Issue Period will be extended for at least three additional working days after revision of Price Band subject to the Bid/ Issue Period not exceeding 10 working days. Any revision in the Price Band and the revised Bid/ Issue Period, if applicable, will be widely disseminated by notification to the Stock Exchanges, by issuing a press release and also by indicating the changes on the websites of the BRLMs and at the terminals of the Syndicate. **Maximum and Minimum Bid Size:** In case of resident Retail Individual Bidders, such number of shares such that the Bid Amount does not exceed ₹ 2,00,000, net of discount, if any. Bids at the Cut-Off Price indicate their agreement to purchase the Equity Shares at the Issue Price, net of discount, if any, as determined at the completion of the Book Building Process. In case of Non-Institutional Bidders and QIBs, such number of shares such that bid amount exceeds ₹ 2,00,000. The maximum Bid by any investor should not exceed the investment limits prescribed for them by applicable laws.
- Please tick Category as applicable to ensure proper upload of Bid in Stock Exchange system.
- Please tick investor status as applicable. Please ensure investor status is updated in your depository records.
- Total Amount payable must be calculated for the highest of three options, at Net Price, i.e., Bid Price, less discount offered, if any, to Bidder's category. The payment instruments for payment into the Escrow Accounts should be drawn in favour of "XYZ Limited IPO - R" in the case of Resident Retail Bidders.
All Bidders would be required to pay the full Bid Amount, net of discount, if any, at the time of the submission of the Bid cum Application Form. Payments should be made by cheque, or a demand draft drawn on any bank (including a co-operative bank), which is situated at, and is a member of or sub-member of the bankers' clearing house located at the centre where the Bid cum Application Form is submitted. Cheques /bank drafts drawn on banks not participating in the clearing process will not be accepted and applications accompanied by such cheques or bank drafts are liable to be rejected. Cash/stock invest/money orders/postal orders will not be accepted. In case of Bids by NRIs applying on non-repatriation basis, the payments must be made through Indian Rupee Drafts purchased abroad or cheques or bank drafts, or out of funds held in Non-Resident External (NRE) Accounts or Foreign Currency Non-Resident (FCNR) Accounts, maintained with banks authorised to deal in foreign exchange in India, along with documentary evidence in support of the remittance or out of a Non-Resident Ordinary (NRO) Account on a non-repatriation basis. Bidders should mention their Application Form Number on the reverse of the cheque /DD to avoid misuse of payment instrument submitted along with the Bid cum Application Form.
For ASBA Bidders, please ensure that your Bank has notified an SCSB Branch in the city where Application Form is being submitted
- Thumb impressions and signatures other than in the languages specified in the Eighth Schedule to the Constitution of India must be attested by a Magistrate or a Notary Public or a Special Executive Magistrate under official seal. Signature of Bank Account Holder is applicable only in case of ASBA option, where Applicant and Bank Holder are different.
- Other Instructions:** a. Bids must be made only in the prescribed Bid cum Application Form. b. Bids must be completed in full, in BLOCK LETTERS in ENGLISH. Bidders should note that the Syndicate Members will not be liable for errors in data entry due to incomplete or illegible Bid cum Application Forms. c. Ensure that all applicable documents in support of the Bid are attached with the Bid cum Application Form

TEAR HERE

	COMPANY CONTACT DETAILS		REGISTRAR CONTACT DETAILS	
	XYZ Limited		Registrar Name	
• In case of queries related to allotment/ credit of allotted equity shares/ refund, the Bidders should contact Registrar to the Issue	Compliance Officer Name		Address	
• In case of ASBA Bids submitted to the SCSBs, the Bidders should contact the relevant SCSB	Address		Tel. No.	
• In case of queries related to upload of ASBA bids submitted to the Syndicate Members, the Bidders should contact the relevant Syndicate Member	Tel. No.		E-mail	
	E-mail			

2 XYZ LIMITED

IN THE NATURE OF ABRIDGED PROSPECTUS - MEMORANDUM CONTAINING SALIENT FEATURES OF THE RED HERRING PROSPECTUS (RHP)

BIDDER'S UNDERTAKING FOR REVISION FORM

I/We (on behalf of joint applicants, if any) confirm that the Transaction Registration Slip (TRS) for my/our bids are enclosed for the revisions which are being requested. I/We agree to be bound by all the terms & conditions mentioned in the Bid cum Application Form submitted earlier by me/us.

I/We (on behalf of joint applicants, if any) authorize you to reject this Bid Revision Form in case any of the details of my existing Bids as appearing on the electronic book building system do not tally with the details given in this Revision Form.

INSTRUCTIONS FOR FILLING UP THE BID REVISION FORM

1. Name of Sole/ First Applicant should be exactly the same as it appears in the depository records.
2. Please ensure that the Bid Options provided are in the same order as that provided in the Bid Cum Application Form submitted earlier.
3. In case there is no change in the particular Bid Option, please write "NO CHANGE". In case you want to cancel the Bid Option, please write "CANCELLED".
4. Total Amount payable must be calculated for the highest of three options, at Net Price, i.e., Bid Price, less discount offered, if any, to Bidder's category. Total amount to be paid must be calculated net of total amount paid at the time of submission of Bid Cum Application Form. The payment instruments for payment into the Escrow Accounts should be drawn in favour of "XYZ Limited - R" in case of Resident Retail Bidders.
For ASBA Bidders, please ensure that your Bank has notified an SCSB Branch in the city where Application Form is being submitted. Please ensure that similar payment option, A or B has been used for submission of Bid Cum Application Form as well as Revision Form. **Revision of Bids in case of Revision of Price Band:** In case of an upward revision in the Price Band, Retail Individual Bidders who had Bid at Cut-off Price could either (i) revise their Bid or (ii) shall make additional payment based on the cap of the revised Price Band (such that the total amount i.e., original Bid Amount less discount, if any, plus additional payment does not exceed ₹ 2,00,000 if the Bidder wants to continue to Bid at Cut-off Price), with the members of the Syndicate to whom the original Bid was submitted. In case the total amount (i.e., original Bid Amount less discount, if any, plus additional payment) exceeds ₹ 2,00,000/-, the Bid will be considered for allocation under the Non-Institutional Portion in terms of the RHP. If, however, the Bidder does not either revise the Bid or make additional payment and the Issue Price is higher than the cap of the Price Band prior to revision, the number of Equity Shares Bid for shall be adjusted downwards for the purpose of Allotment, such that no additional payment would be required from the Bidder and the Bidder is deemed to have approved such revised Bid at Cut-off Price. (i) In case of a downward revision in the Price Band, announced as above, Retail Individual Bidders, who have bid at Cut-off Price could either revise their Bid or the excess amount paid at the time of bidding would be refunded from the Escrow Account.
5. Thumb impressions and signatures other than in the languages specified in the Eighth Schedule to the Constitution of India must be attested by a Magistrate or a Notary Public or a Special Executive Magistrate under official seal. Signature of Bank Account Holder is applicable only in case of ASBA option, where Applicant and Bank Holder are different.
5. **Other Instructions:** a. Bids must be made only in the prescribed Revision Form, as applicable. b. Bids must be completed in full, in BLOCK LETTERS in ENGLISH. Bidders should note that the Syndicate Members will not be liable for errors in data entry due to incomplete or illegible Revision Forms. c. Ensure that Transaction registration Slip ("TRS") for your Bid has and any other applicable documents in support of the Revision are attached with the Revision Form

ISSUE STRUCTURE

QIBs		Non-Institutional Bidders	Retail Individual Bidders
Number of Equity Shares	Upto Equity Shares.	Not less than _____ Equity Shares or issue less allocation to QIB Bidders And Retail Individual Bidders shall be available for allocation.	Not less than _____ Equity Shares or issue less allocation to QIB Bidders and Non- Institutional Bidders shall be available for allocation.
Percentage of Issue available for Allotment/ Allocation	Upto 50% of the Issue shall be Allotted to QIB Bidders. However, atleast 5% of the Net QIB Portion shall be available for allocation proportionately to Mutual Funds only. Mutual Funds participating in the 3% reservation in the Net QIB Portion will also be eligible for allocation in the remaining QIB Portion. Unsubscribed portion in the Mutual Fund reservation will be added to the Net QIB Portion.	Not less than 15% of the Issue or the Issue less allocation to QIB Bidders And Retail Individual Bidders shall be available for allocation.	Not less than 35% of the Issue or the Issue less allocation to QIB Bidders and Non-Institutional Bidders shall be available for allocation.
Basis of allocation irrespective category is oversubscribed	Proportionate. Under-subscription, if any, in any category, would be met with spill over from other categories at our sole discretion in consultation with the BRLMs and the Designated Stock Exchange		
Mode of Allotment	Compulsorily in dematerialised form.	Compulsorily in dematerialised form.	Compulsorily in dematerialised form.
Allotment Lot	A minimum of Equity Shares and thereafter in multiples of Share.		
Trading Lot	One Equity Share.	One Equity Share.	One Equity Share.
Who can Apply	Public financial institutions as in Section 4A of the Companies Act, RIs and their sub-accounts registered with SEBI, other than a sub-account which are foreign corporates or foreign individuals, scheduled commercial banks, Mutual Funds, multilateral and bilateral development financial institutions, state industrial development corporations, insurance companies registered with the Insurance Regulatory and Development Authority, NIF, provident funds with minimum corpus of ₹ 250 million and pension funds with minimum corpus of ₹ 250 million in accordance with applicable law and insurance funds set up and managed by army, navy or air force of Union of India and insurance funds setup and managed by the Department of Posts, India.	Eligible NRIs, Resident Indian individuals, HUF (in the name of the Karta), companies, corporate bodies, scientific institutions, societies and trusts, sub-accounts of RIs, which are foreign corporates or foreign individuals.	Resident Indian individuals and HUFs, in the name of the Karta and Eligible NRIs.
Terms of Payment	The entire Bid Amount less discount, if any, shall be payable at the time of submission of Bid cum Application Form to the members of the Syndicate. In case of ASBA Bidders, the SCSB shall be authorised to block such funds in the bank accounts that are specified in the ASBA Bid cum Application Form.		

XYZ LIMITED



COMMON BID REVISION FORM FOR ASBA / NON-ASBA		XYZ LIMITED - PUBLIC ISSUE - R		FOR RESIDENT INDIAN, QIB, ELIGIBLE NRI's APPLYING ON A NON-REPATRIATION BASIS	
Logo To, The Board of Directors XYZ Limited		BOOK BUILDING ISSUE IN		Bid cum Application Form No.	
SYNDICATE MEMBERS STAMP & CODE 		BROKER'S/AGENTS STAMP & CODE 		1. NAME & CONTACT DETAILS of Sole / First Applicant Mr. / Ms. _____ Tel. No (with STD code) / Mobile _____	
ESCROW BANK / SCSSB BRANCH STAMP & CODE 		SUB-BROKER'S/SUB-AGENTS STAMP & CODE 		2. PAN OF SOLE / FIRST APPLICANT _____	
BANK BRANCH SERIAL NO. 		REGISTRAR'S / SCSSB SERIAL NO. 		3. BIDDER'S DEPOSITORY ACCOUNT DETAILS <input type="checkbox"/> NSDL <input type="checkbox"/> CDSL <small>For NSDL enter 8 digit DP ID followed by 8 digit Client ID / For CDSL, enter 16 digit Client ID</small>	
PLEASE CHANGE MY BID					
2. FROM (as per last Bid or Revision)					
Bid Options No. of Equity Shares Bid (Bids must be in multiples of Bid Lot as advertised) (In Figures)		Price per Equity Share (₹) "Cut-off" (Price in multiples of ₹ 1/- only) (In Figures)			
7 6 5 4 3 2 1		Bid Price Discount, if any Net Price "Cut-off" (Please tick)			
Option 1					
(OR) Option 2					
(OR) Option 3					
3. TO (Revised Bid)					
Bid Options No. of Equity Shares Bid (Bids must be in multiples of Bid Lot as advertised) (In Figures)		Price per Equity Share (₹) "Cut-off" (Price in multiples of ₹ 1/- only) (In Figures)			
7 6 5 4 3 2 1		Bid Price Discount, if any Net Price "Cut-off" (Please tick)			
Option 1					
(OR) Option 2					
(OR) Option 3					
4. PAYMENT DETAILS (Please tick (✓) any one of payment option A or B below) PAYMENT OPTIONS <input type="checkbox"/> Full Payment <input type="checkbox"/> Part Payment					
Additional Amount Paid (₹ in figures) _____ (₹ in words) _____					
<input type="checkbox"/> (A) CHEQUE/ DEMAND DRAFT (DD) <input type="checkbox"/> (B) ASBA Cheque/DD No. _____ Dated <u>DD/MM/YY</u> Bank A/c No. _____ Drawn on (Bank Name & Branch) _____ Bank Name & Branch _____					
<small>I/WE (ON BEHALF OF JOINT APPLICANTS, IF ANY) HEREBY CONFIRM THAT I/WE HAVE READ AND UNDERSTOOD THE TERMS AND CONDITIONS OF THIS BID REVISION FORM AND THE ATTACHED FORM 2A AND HEREBY AGREE AND CONFIRM THE BIDDERS UNDERTAKING AS GIVEN OVER LEAF. I/We (on behalf of joint applicants, if any) hereby confirm that I/We have read the Instructions for Filing up the Bid revision Form given overleaf.</small>					
5A. SIGNATURE OF SOLE/ JOINT APPLICANT(S) Date : _____, 2011		5B. SIGNATURE OF ASBA BANK ACCOUNT HOLDER(S) (AS PER BANK RECORDS) (FOR ASBA OPTION ONLY) I/We authorize the SCSSB to do all acts as are necessary to make the Application in the issue 1) _____ 2) _____ 3) _____		BROKER'S / SCSSB BRANCH'S STAMP (Acknowledging upload of Bid in Stock Exchange system)	
TEAR HERE					
XYZ LIMITED BID REVISION FORM		Acknowledgement Slip for Syndicate Member / SCSSB		Bid cum Application Form No.	
DPID / CLID _____		PAN _____		_____	
Additional Amount Paid (₹) _____		Bank & Branch _____		Stamp & Signature of Banker _____	
Cheque / DD/ASBA Bank A/c No. _____		Received from Mr./Ms. _____		Telephone / Mobile _____ Email _____	
TEAR HERE					
XYZ LIMITED BID REVISION FORM		Acknowledgement of Syndicate Member / SCSSB		Name of Sole / First Applicant	
No. of Equity Shares _____ Bid Price _____ Additional Amount Paid (₹) _____ Cheque / DD/ASBA Bank A/c No. _____ Bank & Branch _____		_____		_____	
Acknowledgement Slip for Bidder		Bid cum Application Form No.		_____	

Self-Assessment Questions

- ❖ The culmination of an IPO is
 - QIP
 - FPO
 - **Listing**
 - ASBA
- ❖ Issue of shares to new investors calls for _____ from current investors
 - Ordinary resolution
 - **Special resolution**
 - Two-thirds majority approval
 - No approval
- ❖ 'Offer for sale' can be part of:
 - IPO
 - FPO
 - **Either of the above**
 - None of the above
- ❖ Preferential allotment shares are locked in for
 - 1 year
 - 3 years
 - 1 year for non-promoters
 - **1 year for non-promoters and 3 years for promoters**
- ❖ It is compulsory for companies coming out with a public issue to offer demat facility
 - **True**
 - False
- ❖ ASBA is available for
 - IPO
 - IPO and FPO
 - Rights
 - **All the above**

Chapter 3: Secondary Market (Trading in Shares)

3.1 National Stock Exchange

NSE provides trading in four different segments - Wholesale Debt Market, Capital Market, Futures and Options and Currency Derivatives Segment.

- *Wholesale Debt Market (WDM) Segment*

This segment at NSE commenced its operations in June 1994. It provides the trading platform for wide range of debt securities which includes State and Central Government securities, T-Bills, PSU Bonds, Corporate debentures, Commercial Papers, Certificate of Deposits etc.

- *Capital Market (CM) Segment*

This segment at NSE commenced its operations in November 1995. It offers a fully automated screen based trading system, known as the National Exchange for Automated Trading (NEAT) system. Various types of securities e.g. equity shares, warrants, debentures etc. are traded on this system.

- *Futures & Options (F&O) Segment*

This segment provides trading in derivatives instruments like index futures, index options, stock options, and stock futures, and commenced its operations at NSE in June 2000.

- *Currency Derivatives Segment (CDS) Segment*

This segment at NSE commenced its operations on August 29, 2008, with the launch of currency futures trading in US Dollar-Indian Rupee (USD-INR). Currency futures are now available for USD, GBP, Euro and JPY. Currency options are available for USD. 'Interest rate futures' was another product made available for trading on this segment with effect from August 31, 2009.

3.2 Trading Members & Clearing Members

A stock broker is an intermediary who arranges to buy and sell securities on the behalf of clients (the buyer and the seller).

According to SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, a stockbroker is member of a stock exchange and is required to hold a certificate of registration from SEBI in order to buy, sell or deal in securities.

Stockbrokers need to become Trading Members (TM) of NSE in order to help their clients to trade using the NSE platform.

3.3 *Authorised Persons & Sub-brokers*

Trading members of the Exchange can appoint authorised persons in the Futures & Options and Currency Derivatives Segments. An authorised person introduces clients to the trading member and receives remuneration/ commission/ compensation from the trading member and not from the clients.

The clients introduced by the authorised person are required to deliver securities and make payments directly in the trade name of the trading member (as appearing on the SEBI registration certificate). Similarly, the trading member should deliver securities and make payments directly in the name of the clients.

The Trading Members of the Exchange may appoint sub-brokers to act as agents of the concerned Trading Member for assisting investors in buying, selling or dealing in securities. Sub-brokers are affiliated to the Trading Members, and are required to be registered with SEBI. A sub-broker is allowed to be associated with only one Trading Member of the Exchange. The Trading Member has to ensure the settlement of all its deals, even if the deals may have originated from its sub-broker.

A sub-broker is required to enter into a tripartite agreement with its clients and the stock broker specifying the scope of rights and obligations of the parties viz. sub-broker, the stock broker and such client of the sub-broker.

A sub-broker also needs to provide assistance to the stock broker and clients to reconcile their accounts at the end of each quarter, with reference to all the settlements where payouts have been declared during the quarter.

3.4 *Trading Member's Responsibilities for Trades*

Contract note is a confirmation of trade(s) done on a particular day for and on behalf of a client.

A stock-broker should issue a contract note to his clients for trades (purchase/ sale of securities). The contract note should contain name and address (registered office address as well as dealing office address) of the Trading Member, the SEBI registration number of the Trading Member, details of trade viz. order number, trade number, order time, trade time, security name, quantity, trade price, brokerage, settlement number and details of other levies.

Even for clients introduced through a sub-broker, the stock broker needs to issue contract notes as per the format prescribed by the Exchange. Sub-broker should not issue any purchase/sale note or confirmation memo to its client.

The Trading Member is required to preserve the duplicate copy of the contract notes issued for a minimum of five years. The TM should ensure that:

- (a) Contract note is issued to a client within 24 hours and should be signed by the trading member or by an authorized signatory of the trading member;
- (b) Contract notes are in the prescribed format;
- (c) Stamp duty is paid;
- (d) All statutory levies are shown separately in the contract note.

Clients can ask for contract notes to be sent in electronic form. In that case, the stock broker has to send the Electronic Contract Notes (ECN) to the e-mail ID that the client provides.

The stock broker needs to ensure that all ECNs sent through the e-mail are digitally signed, encrypted, non-tamperable and in compliance with the provisions of the IT Act, 2000. In case, ECN is sent through e-mail as an attachment, the attached file has to be secured with the digital signature, encrypted and non-tamperable.

Every Trading Member should make payments to his clients or deliver the securities purchased within one working day of pay-out unless the client has requested otherwise.

The maximum brokerage chargeable by the Trading Member in respect of trades effected in the securities admitted for dealing on the CM segment of the Exchange is fixed at 2.5% of the contract price, exclusive of statutory levies. This maximum brokerage is inclusive of sub-brokerage. The sub-broker is entitled to sub-brokerage not exceeding 1.5% of the transaction value.

The brokerage should be indicated separately from the price, in the contract note. The TM is not supposed to share the brokerage with a person who is a TM or in employment of another TM.

The Trading Member should maintain separate bank accounts for the client's funds and the member's own funds.

Funds should be transferred from the client account to the clearing account for the purpose of funds pay-in obligations on behalf of the clients and vice-versa in case of funds pay-out.

No payment for a transaction in which the Trading Member is taking position as a principal, is allowed to be made from the client's account.

The Trading Members should keep the dematerialised securities of constituents in a separate beneficiary account, distinct from the beneficiary account maintained for holding their own dematerialised securities.

No delivery towards the own transactions of the Trading Members is allowed to be made from the account meant for constituents. For this purpose, every Trading Member is required to open a beneficiary account in the name of the Trading Member exclusively for the securities of the constituents (to be referred to as "constituents' beneficiary account").

A trading member may keep one consolidated constituents' beneficiary account for all its constituents or different accounts for each of its constituents as it may deem fit.

Transactions in securities executed on behalf of a client introduced through the sub-broker, should be settled by delivery/ payment between the stock broker and the client directly, in accordance of the rules, regulations and byelaws of the Exchange. Such settlements should not take place through sub-broker.

The rights and obligations are discussed in greater detail in Annexure 4.

3.5 Uniform Documentation for Opening Trading Account

SEBI has devised uniform documentation to be followed by all the stock brokers/ trading members for opening trading account for clients. These are listed in the Annexures:

Annexure 1: Account Opening Kit – Index of Documents

Annexure 2: KYC Application Form – For Individuals and Non-Individuals

Annexure 3: Trading Account Related Details

Annexure 4: Rights and Obligations of Stock-brokers, Sub-brokers & Clients

Annexure 5: Risk Disclosure Document for Capital Market and Derivatives Segments

Annexure 6: Guidance Note - Do's and Don'ts for Trading on the Exchange(s) for Investors

3.6 Screen-based Trading System (SBTS)

NEAT is a SBTS. Under this system a trading member can punch into the computer, the number of securities and the prices at which he would like to transact. The transaction is executed as soon as the system is able to find a matching sell or buy order from a counter party.

An active order tries to find a match on the other side of the books. If it finds a match, a trade is generated. If it does not find a match, the order becomes a passive order and goes and sits in the order book, as per the price/time priority.

- Price priority means that if two orders are entered into the system, the order having the best price gets the higher priority. Best price for a sell order is the lowest price and for a buy order, it is the highest price.
- Time priority means if two orders having the same price is entered, the order that is entered first gets the higher priority.

All quantity fields are in units and prices are quoted in Indian Rupees.

3.7 Trade Management

A trade is an activity in which a buy and a sell order match with each other. This is done automatically by the system. Whenever a trade takes place, the system sends a trade confirmation message to each of the users involved in the trade.

The trade confirmation slip gets printed at the trader workstation of the user with a unique trade number. The system also broadcasts a message to the entire market through the ticker window displaying the details of the trade.

Trade management activities are traditionally categorized as follows:

- Front Office: Trade capture and execution
- Middle Office: Validation / Confirmation of the trades and Risk management. This is characteristic of institutional trades
- Back Office: Clearing & Settlement; Accounting

These are discussed in the following sections.

3.8 Market Types

The Capital Market system has four types of market:

3.8.1 Normal Market

Normal market consists of various book types as follows:

- An order that has no special condition associated with it is a *Regular Lot order*.
- Orders which have a special term attribute attached to it are known as *special terms orders*. Currently this facility is not available in the trading system.
- *Stop Loss (SL) orders* are released into the market when the last traded price for that security in the normal market reaches or surpasses the *trigger price*. Before triggering, the order does not participate in matching and the order cannot get traded. Untriggered stop loss orders are stacked in the stop loss book.

The stop loss orders can be either a market order (i.e. no specific price limit is set) or a limit price order (i.e. trade happens only at or better than the limit price indicated).

- o For buy SL orders, the trigger price has to be less than or equal to the limit price.
- o Similarly, for sell SL orders, the trigger price has to be greater than or equal to the limit price.
- Two trading members can negotiate a trade outside the Exchange. To regularise the trade, each trading member has to enter the respective order in the system. These are called *negotiated orders*.

For Negotiated Trade order, it is mandatory for the trading member to enter the counterparty trading member ID. When both parties to a trade enter orders, then the request goes to the Exchange for approval. The Exchange can either approve the request or reject it. Further, the Exchange has the discretion to send either of the two orders or both the orders to the Regular Lot book so that the orders are available to the entire market. Currently this facility is not available in the trading system.

3.8.2 Auction Market

In the auction market, auctions are initiated by the exchange on behalf of trading members for settlement related reasons.

3.8.3 Odd Lot Market

The odd lot market facility is used for the Limited Physical Market and for the Block Trades Session. The Odd Lot book can be selected in the order entry screen in order to trade in the Odd Lot market.

The limited physical market provides an exit route for small investors holding physical shares in securities mandated for compulsory dematerialised settlement. The Exchange has provided a facility for such trading in physical shares not exceeding 500 shares. The Trading Member is required to ensure that the shares are duly registered in the name of the seller. The trading hours are the same as the regular market. Order matching happens on the basis of both price and quantity match. Each trade is settled separately, on a trade-to-trade basis i.e. multiple trades are not combined and netted for settlement purposes.

Block Trading is a 35 minute market i.e. the trading window normally remains open from 9:00 hours to 9:35 hours. There is no pre-open and post close in the block trade session.

For a block trade, order should be of a minimum quantity of 5,00,000 shares or minimum value of Rs 5 crore, whichever is lower. Orders get matched when both the price and the quantity match for the buy and sell order. Orders with the same price and quantity are matched on time priority i.e. orders which have come into the system before will get matched first.

Currently, market order is not allowed in this session. Order with special terms such as 'Stop Loss', 'Disclosed Quantity' are also not available.

3.8.4 Retail Debt Market

The RETDEBT market facility on the NEAT system of capital market segment is used for transactions in Retail Debt Market session. Trading in Retail Debt Market takes place in the same manner as in equities (capital market) segment.

3.9 Margin Trading

Margin trading is a facility for investors to trade in securities with borrowed funds provided by the broker or other financier. If an investor is allowed to buy securities with 30% margin, it means that the investor needs to pay only 30% of the price of the securities purchased. The balance will be financed in the form of a loan.

The 30% margin needs to be maintained at all times. If the market falls, then the broker will call for additional funds from the investor. This is called a 'margin call'. If the investor does not pay the margin call, then the broker will sell off some investments of the investor.

Corporate brokers with net worth of at least Rs.3 crore are eligible for providing Margin trading facility to their clients subject to their entering into an agreement. The client cannot avail of the facility from more than one broker.

The broker can provide the margin funds through own resources or borrowing from banks or NBFCs regulated by SEBI. Borrowing from other sources is not permitted.

The “total exposure” of the broker towards the margin trading facility should not exceed the borrowed funds and 50 per cent of his “net worth”. Further, single client exposure limit is 10% of the total exposure of the broker.

3.10 Exchange Margins

The Exchange levies daily margin, Mark-to-Market (MTM) margin and Extreme loss margin in the equities segment; and initial margin and MTM margin in case of futures and options segment.

The broker needs to maintain upfront capital with the exchange to cover his daily margin at the time of order placement. To ensure this, the broker collects upfront margin by way of funds/ shares from the client and deposits the same with the exchange.

Broker is expected to inform the exchanges of any defaulting clients or de-faulting sub-brokers.

3.11 Settlement

3.11.1 Clearing House

Once trades are executed, their clearing and settlement are handled by the Clearing House (CH) / Clearing Corporation (CC).

The National Securities Clearing Corporation Ltd. (NSCCL), a wholly owned subsidiary of NSE, is responsible for clearing and settlement of trades executed in the NSE. As part of this role, NSCCL guarantees all the trades against counter-party risk. Thus, anyone who trades in the stock exchange, can be sure of the trade getting properly executed. Further, NSCCL helps in managing the risk in the market through an effective margining system.

NSCCL also undertakes settlement of transactions on other stock exchanges like, the Over the Counter Exchange of India.

The NSCCL clears all trades, determines obligations of members, arranges for pay-in of funds/ securities, receives funds / securities, processes for shortages in funds/securities, arranges for pay-out of funds/securities to members, guarantees settlement, and collects and maintains margins / collateral base capital / other funds.

3.11.2 Other Agencies Involved in Settlement

- **Clearing Members**

They are responsible for settling the obligations of TM for whom they are responsible. The obligations are determined by the NSCCL based on trades executed by the TM.

Clearing Members have to make available funds and/or securities in the designated accounts with clearing bank/ depository participant, as the case may be, to meet their obligations on the settlement day.

In the capital market segment, all trading members of the Exchange are required to become the Clearing Member of the Clearing Corporation.

Self-Clearing Members (SCM) have the right to clear their own trades, but not the trades of other members. Trading-cum-Clearing Members are authorized to clear their own trades, as well as trades of other members.

Professional clearing members (PCM) clear but do not trade. PCMs operate only in the F&O segment.

- Custodians

In NSCCL, custodian is a clearing member but not a trading member. The custodian settles trades assigned by trading members.

The custodian has documentary evidence of the title to the securities traded (ownership is with the person who owns the security).

The custodian is required to confirm whether it is going to settle a particular trade or not. If it is confirmed, the NSCCL assigns that obligation to that custodian and the custodian is required to settle it on the settlement day. If the custodian rejects the trade, the obligation is assigned back to the trading / clearing member.

- Clearing Banks

Clearing banks are a key link between the clearing members and NSCCL for funds settlement. Every clearing member is required to open a dedicated settlement account with one of the clearing banks. Based on his obligation as determined through clearing, the clearing member makes funds available in the clearing account for the pay-in and receives funds in case of a pay-out.

- Depositories

A depository is an entity where the securities of an investor are held in electronic form. The person who holds a demat account is a beneficiary owner. In case of a joint account, the account holders are beneficiary holders of that joint account.

Depositories help in the settlement of the dematerialised securities. Each custodian/clearing member is required to maintain a clearing pool account with the depositories. He is required to make available the required securities in the designated account on settlement day.

The depository runs an electronic file to transfer the securities from accounts of the custodians/clearing member to that of NSCCL on the pay-in day.

Similarly, as per the schedule of allocation of securities determined by the NSCCL, the depositories transfer the securities on the pay-out day from the account of the NSCCL to those of members/ custodians.

3.11.3 Clearing Mechanism

The clearing mechanism essentially involves working out open positions and obligations of clearing (self-clearing/ trading-cum-clearing/ professional clearing) members. This position is considered for exposure and daily margin purposes.

The open position of a CM is arrived at by aggregating the open positions of all the TMs and all custodial participants clearing through him, in contracts in which they have traded.

A TM's open position is arrived at as the summation of his proprietary open position and his clients' open positions, in the contracts in which he has traded.

- Proprietary positions are calculated on net basis (buy - sell) for each contract.
- Clients' positions are arrived at by summing together net (buy - sell) positions of each individual client.

A TM's open position is the sum of proprietary open position, client open long position and client open short position.

3.11.4 Clearing Process

At the end of each trading day, concluded or locked-in trades are received from NSE by NSCCL.

The NSCCL interposes itself as a central counterparty between the two counterparties of every trade, and nets the positions so that a member has security wise net obligation to receive or deliver a security and has to either pay or receive funds. A multi-lateral netting procedure is adopted for the purpose.

On this basis, NSCCL determines the amount / securities that each counter-party owes or is due to receive on the settlement date. NSCCL electronically transfers the data to Clearing Members (CMs).

3.11.5 Settlement Process

The settlement process begins as soon as Trading Members' obligations are determined through the clearing process. The clearing banks and depositories provide the necessary interface between the custodians/ clearing members (who clear for the trading members or their own transactions) for settlement of these obligations.

The clearing corporation provides a major link between the clearing banks, clearing members and the depositories. This link ensures actual movement of funds and securities on the prescribed pay-in and pay-out day.

- Pay-in day is the day when the trading members/ brokers are required to make payment of funds or delivery of securities to the clearing corporation of the Exchange for all transactions traded by or through them on the trading day (Day T).

- o Securities Pay-in
This is the process of delivering securities to the clearing corporation to effect settlement of a sale transaction.
- o Funds Pay-in
This is the process of transfer of funds to the clearing corporation to pay for purchase transactions.
- Pay-out day is the day when the clearing corporation of the stock exchange transfers funds and securities to the broker / Trading Member, to clear their receivable position.
 - o Securities Pay-out
This is the process of receiving securities from the clearing corporation to complete the securities settlement of a purchase transaction.
 - o Funds Pay-out
This is the process of transfer of funds from the clearing corporation to complete the funds settlement of a sale transaction.

3.11.6 Transaction Cycle

As illustrated in Figure 3.1, the transaction goes through following stages:

- (a) A person holding assets (securities/funds), either to meet his liquidity needs or to reshuffle his holdings in response to changes in his perception about risk and return of the assets, decides to buy or sell the securities.
- (b) He selects a broker and instructs him to place buy/sell order on an exchange.
- (c) The order is converted to a trade as soon as it finds a matching sell/buy order.
- (d) At the end of the day, various such trades are netted to determine the obligations of each Trading Member to deliver securities/ funds as per the settlement schedule.
- (e) Buyer (seller) delivers funds (securities) and receives securities (funds) and acquires ownership of the securities.

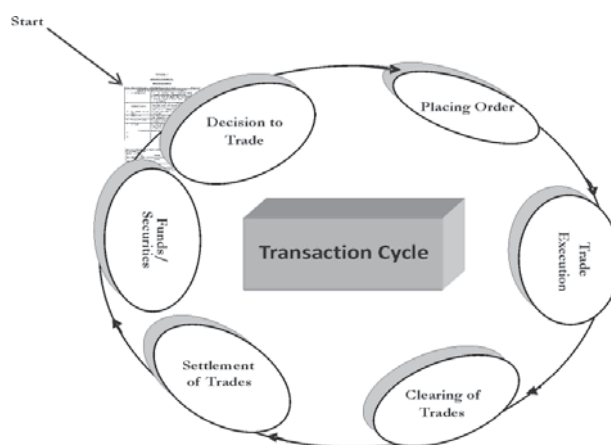


Figure 3.1: Transaction Cycle

Two critical activities in the settlement process are:

- Pay-in of Funds and Securities

The members bring in their funds/ securities to the NSCCL.

Members with securities obligations make available the required securities in designated accounts with the depositories by the prescribed pay-in time. The depositories move the securities available in the accounts of members to the account of the NSCCL.

Likewise, members with funds obligations make available the required funds in the designated accounts with clearing banks by the prescribed pay-in time. The NSCCL sends electronic instructions to the clearing banks to debit the member's accounts to the extent of payment obligations. The banks process these instructions, debit the accounts of the members and credit the accounts of the NSCCL.

- Pay-out of Funds and Securities

After processing for shortages of funds/ securities and arranging for movement of funds from surplus banks to deficit banks through RBI clearing, the NSCCL sends electronic instructions to the depositories/ clearing banks to release pay-out of securities/ funds.

The depositories and clearing banks debit the accounts of NSCCL and credit the settlement accounts of members.

- Direct Payout

NSCCL has introduced the facility of direct payout (i.e. direct delivery of securities) to clients' account. It ascertains from each clearing member, the beneficiary account details of their respective clients who are due to receive pay out of securities.

Based on the information received from members, the clearing corporation sends payout instructions to the depositories, so that the client receives the pay out of securities directly to their accounts on the pay-out day. The client receives payout to the extent of instructions received from the respective clearing members. To the extent of instruction not received, the securities are credited to the CM pool account of the member.

Settlement is deemed to be complete upon declaration and release of pay-out of funds and securities.

The settlement process for transactions in securities in the CM segment of NSE is presented in the Figure 3.2.

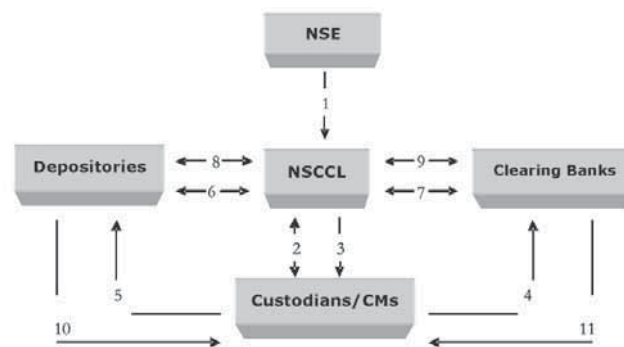


Figure 3.2: Settlement Process in CM segment of NSE

Explanation for Figure 3.2:

- (1) Trade details from Exchange to NSCCL (real-time and end of day trade file).
- (2) NSCCL notifies the consummated trade details to CMs/ custodians who affirm back. Based on the affirmation, NSCCL applies multilateral netting and determines obligations.
- (3) Download of obligation and pay-in advice of funds/securities.
- (4) Instructions to clearing banks to make funds available by pay-in time.
- (5) Instructions to depositories to make securities available by pay-in-time.
- (6) Pay-in of securities (NSCCL advises depository to debit pool account of custodians/CMs and credit its account and depository does it).
- (7) Pay-in of funds (NSCCL advises Clearing Banks to debit account of custodians/ CMs and credit its account and clearing bank does it).
- (8) Pay-out of securities (NSCCL advises depository to credit pool account of custodians/ CMs and debit its account and depository does it).
- (9) Pay-out of funds (NSCCL advises Clearing Banks to credit account of custodians/ CMs and debit its account and clearing bank does it).
- (10) Depository informs custodians/ CMs through DPs.
- (11) Clearing Banks inform custodians/ CMs.

A fixed schedule (number of days from the Trade Date) is set for each stage in the settlement process, including post-settlement activities like handling of auctions and bad deliveries. Physical securities and dematerialised securities have different schedules. This is discussed in the next section.

3.11.7 T+2 Rolling Settlement Calendar

Indian capital market follows T+2 Rolling Settlement. T is the transaction date. '+2' denotes the number of days for settlement. Thus, trades done on Monday are settled 2 working days later viz. Wednesday.

The activity schedule is as follows:

Sl. No.	Day	Time	Activity
1	T		Trade Day
2	T+1	By 1:00 pm	Completion of custodial confirmation of trades to CC/CH
		By 2:30 pm	Completion of process and download obligation files to brokers/ custodians by the CC/CH
3	T+2	Until 10:30 am	Accept Pay-in instructions from investors into pool account
		By 10:30 am	Submit final pay-in files to the depository and the clearing bank
		By 1:30 pm	Pay-out of securities and funds

3.11.8 Delivery Versus Payment (DVP) / Hand Delivery

All transactions executed on the stock exchanges are to be settled through the Clearing Corporation/House of the stock exchanges. However, the following exceptions are provided:

- Total connectivity failure to the exchange/STP
(Specific connectivity issues of the custodians and members are not to be considered as valid exceptions)
- International Holidays that may be decided upfront by the stock exchanges in consultation with the custodians.
- Closing down of national/international centres due to calamities

3.11.9 Auction Settlement

Auctions are initiated by the Exchange on behalf of trading members for settlement related reasons. The main reasons are shortages, bad deliveries and objections.

As already discussed, trade would be normally settled as follow:

Sl. No.	Day	Activity
1	T	Trade Day
2	T+2	Pay-in/Pay-out of securities and funds

In the event of a shortage, the auction will proceed as follows:

Sl. No.	Day	Activity
3	T+2	Auction Session
4	T+3	Pay-in/Pay-out and close-out of auction

In case of bank holidays, when multiple settlements (say S_1 and S_2) are conducted on the same day (say T_m), on the working day immediately following the day(s) of the closure, the auction session shall be as under:

- The auction of first settlement (S_1) shall be conducted on the same day (T_m) and settled the next day (T_m+1).
- The auction for the second settlement (S_2) shall be conducted on the next day (T_m+1) along with the shortages/auction of that day. The settlement of the same shall happen on the subsequent day (T_m+2).

Exceptions may arise when CMs deliver less than their obligation (short delivery of securities) or if there are bad deliveries or company objections on the pay-out day.

NSCCL identifies the short deliveries and conducts a buying-in auction on the day after the pay-out day through the NSE trading system.

The delivering CM is first debited by an amount equivalent to the securities not delivered and valued at a valuation price (the closing price as announced by NSE on the day previous to the day of the valuation). If the buy-in auction price is more than the valuation price, the CM is required to make good the difference.

All shortages not bought-in are deemed closed out at the highest price between the first day of the trading period till the day of squaring off or closing price on the auction day plus 20%, whichever is higher. This amount is credited to the receiving member's account on the auction pay-out day.

In the case of close out for scrips which have been indefinitely suspended/ delisted, the reference price would be the twenty-six weeks average traded price while the close out mark up would be 20%.

The debentures and bond issued by the companies which are traded at the exchanges do not experience daily price variation in fashion similar to the equities. Therefore close out mark up of 5% would be applied in case of debentures and bonds which are assigned a credit rating of triple A and above. However, for the other debentures and the bonds without the triple A credit rating, the existing close out mark up of 20% shall be applicable as is applicable in the case of equities.

The Proceeds from Auction/ Close-out should be used to settle the claim of the aggrieved party. Any amount remaining thereof should be credited to the Investor Protection Fund instead of crediting it to the defaulting party's account.

3.11.10 F&O Settlement

All futures and options contracts are cash settled, i.e. settled through exchange of cash.

The settlement amount for a CM is netted across all their TMs/clients, with respect to their obligations on Mark to Market (MTM), premium and exercise settlement.

- Settlement of Futures Contracts

Futures contracts have two types of settlements, the MTM settlement which happens

on a continuous basis at the end of each day, and the final settlement which happens on the last trading day of the futures contract.

o **MTM Settlement**

All futures contracts for each member are marked-to-market (MTM) to the daily settlement price of the relevant futures contract at the end of each day. The profits/losses are computed as the difference between:

1. The trade price and the day's settlement price for contracts executed during the day but not squared up.
2. The previous day's settlement price and the current day's settlement price for brought forward contracts.
3. The buy price and the sell price for contracts executed during the day and squared up.

Table [3.1] explains the MTM calculation for a member. The settlement price for the contract for today is assumed to be 105.

Table [3.1]: Computation of MTM at the end of the day

Trade details	Quantity bought/sold	Settlement price	MTM
Brought forward from previous day	100@100	105	500
Traded during day Bought	200@100	102	200
Sold	100@102		
Open position (not squared up)	100@100	105	500
Total			1200

- The margin charged on the brought forward contract is the difference between the previous day's settlement price of Rs100 and today's settlement price of Rs105.
- Hence on account of the position brought forward, the MTM shows a profit of $100 \times \text{Rs}5$ i.e. Rs500.
- For contracts executed during the day, the difference between the buy price and the sell price determines the MTM.
- In this example, 200 units are bought @ Rs100 and 100 units sold @ Rs102 during the day. Hence the MTM for the position closed during the day shows a profit of $100 \times \text{Rs}2$ i.e. Rs200.
- Finally, the open position of contracts traded during the day, is margined at the day's settlement price and the profit of $100 \times \text{Rs}5$ i.e. Rs500 credited to the MTM account.

So the MTM account shows a profit of Rs. 1200.

The CMs who have a loss are required to pay the mark-to-market (MTM) loss amount in cash, which is, in turn, passed on to the CMs who have made a MTM profit. This is known as daily mark-to-market settlement.

CMs are responsible to collect and settle the daily MTM profits/losses incurred by the TMs and their clients clearing and settling through them.

Similarly, TMs are responsible to collect/pay losses/profits from/to their clients by the next day.

The pay-in and pay-out of the mark-to-market settlement are effected on the day following the trade day (T+1).

In case a futures contract is not traded on a day, or not traded during the last half hour, a 'theoretical settlement price' is computed as per the continuous compounding formula:

$$F = Se^{rt}$$

Where, 'F' is the futures price, 'S' is the spot price of the underlying, 'r' is the risk free rate and 't' is the time in years. $E = 2.71828$.

After completion of daily settlement computation, all the open positions are reset to the daily settlement price. Such positions become the open positions for the next day.

o Final Settlement

On the expiry day of the futures contracts, after the close of trading hours, NSCCL marks all positions of a CM to the final settlement price and the resulting profit/loss is settled in cash.

Final settlement loss/profit amount is debited/ credited to the relevant CM's clearing bank account on the day following expiry day of the contract.

o Settlement prices for futures

- Daily settlement price on a trading day is the closing price of the respective futures contracts on such day. The closing price for a futures contract is currently calculated as the last half an hour weighted average price of the contract in the F&O Segment of NSE.
- Final settlement price is the closing price of the relevant underlying index/security in the capital market segment of NSE, on the last trading day of the contract. The closing price of the underlying index/security is currently its last half an hour weighted average value in the capital market segment of NSE.

- Settlement of Options Contracts

Options contracts have three types of settlements, daily premium settlement, exercise settlement, interim exercise settlement in the case of option contracts on securities and final settlement.

- o Daily premium settlement

Buyer of an option is obligated to pay the premium towards the options purchased by him.

Similarly, the seller of an option is entitled to receive the premium for the option sold by him.

The premium payable amount and the premium receivable amount are netted to compute the net premium payable or receivable amount for each client for each option contract.

- o Exercise Settlement

Although most option buyers and sellers close out their options positions by an offsetting closing transaction, an understanding of exercise can help an option buyer determine whether exercise might be more advantageous than an offsetting sale of the option.

There is always a possibility of the option seller being assigned an exercise. Once an exercise of an option has been assigned to an option seller, the option seller is bound to fulfil his obligation (meaning, pay the cash settlement amount in the case of a cash-settled option) even though he may not yet have been notified of the assignment.

- Interim exercise settlement

Interim exercise settlement takes place only for option contracts on securities.

An investor can exercise his in-the-money options at any time during trading hours, through his trading member. Interim exercise settlement is effected for such options at the close of the trading hours, on the day of exercise.

Valid exercised option contracts are assigned to short positions in the option contract with the same series (i.e. having the same underlying, same expiry date and same strike price), on a random basis, at the client level.

The CM who has exercised the option receives the exercise settlement value per unit of the option from the CM who has been assigned the option contract.

- Final exercise settlement

Final exercise settlement is effected for all open long in-the-money strike

price options existing at the close of trading hours, on the expiration day of an option contract.

All such long positions are exercised and automatically assigned to short positions in option contracts with the same series, on a random basis.

The investor who has long in-the-money options on the expiry date will receive the exercise settlement value per unit of the option from the investor who is short on the option.

- Exercise process

The period during which an option is exercisable depends on the style of the option.

- On NSE, index options are European style, i.e. options are only subject to automatic exercise on the expiration day, if they are in-the-money.
- As compared to this, options on securities are American style. In such cases, the exercise is automatic on the expiration day, and voluntary prior to the expiration day of the option contract, provided they are in-the-money.

Automatic exercise means that all in-the-money options would be exercised by NSCCL on the expiration day of the contract. The buyer of such options need not give an exercise notice in such cases.

Voluntary exercise means that the buyer of an in-the-money option can direct his TM/CM to give exercise instructions to NSCCL.

In order to ensure that an option is exercised on a particular day, the buyer must direct his TM to exercise before the cut-off time for accepting exercise instructions for that day.

Usually, the exercise orders will be accepted by the system till the close of trading hours. Different TMs may have different cut-off times for accepting exercise instructions from customers, which may vary for different options. An option, which expires unexercised becomes worthless.

Some TMs may accept standing instructions to exercise, or have procedures for the exercise of every option, which is in-the-money at expiration.

Once an exercise instruction is given by a CM to NSCCL, it cannot ordinarily be revoked.

Exercise notices given by a buyer at any time on a day are processed by NSCCL after the close of trading hours on that day. All exercise notices received by NSCCL from the NEAT F&O system are processed to determine their validity. Some basic validation checks are carried out to check the open

buy position of the exercising client/TM and if option contract is in-the-money. Once exercised contracts are found valid, they are assigned.

- Assignment process

The exercise notices are assigned in standardized market lots to short positions in the option contract with the same series (i.e. same underlying, expiry date and strike price) at the client level. Assignment to the short positions is done on a random basis. NSCCL determines short positions, which are eligible to be assigned and then allocates the exercised positions to any one or more short positions. Assignments are made at the end of the trading day on which exercise instruction is received by NSCCL and notified to the members on the same day.

- Exercise settlement computation

In case of index option contracts, all open long positions at in-the-money strike prices are automatically exercised on the expiration day and assigned to short positions in option contracts with the same series on a random basis.

For options on securities, interim exercise for an open long in-the-money option position can be effected on any day till the expiry of the contract.

For options on securities, final exercise is automatically effected by NSCCL for all open long in-the-money positions in the expiring month option contract, on the expiry day of the option contract.

The exercise settlement price is the closing price of the underlying (index or security) on the exercise day (for interim exercise) or the expiry day of the relevant option contract (final exercise).

The exercise settlement value is the difference between the strike price and the final settlement price of the relevant option contract.

- For call options, the exercise settlement value receivable by a buyer is the difference between the final settlement price and the strike price for each unit of the underlying conveyed by the option contract.

- For put options it is the difference between the strike price and the final settlement price for each unit of the underlying conveyed by the option contract.

Settlement of exercises of options on securities is currently by payment in cash and not by delivery of securities. It takes place for in-the-money option contracts.

For final exercise the closing price of the underlying security is taken on the expiration day. The exercise settlement value is debited / credited to the relevant CMs clearing bank account on T + 1 day (T = exercise date).

- Special facility for settlement of institutional deals

NSCCL provides a special facility to Institutions/ Foreign Institutional Investors (FIIs)/ Mutual Funds etc. to execute trades through any TM, which may be cleared and settled by their own CM. Such entities are called custodial participants (CPs).

To avail of this facility, a CP is required to register with NSCCL through his CM. A unique CP code is allotted to the CP by NSCCL. All trades executed by a CP through any TM are required to have the CP code in the relevant field on the trading system at the time of order entry.

Such trades executed on behalf of a CP are confirmed by their own CM (and not the CM of the TM through whom the order is entered), within the time specified by NSE on the trade day through the on-line confirmation facility.

Till such time the trade is confirmed by CM of concerned CP, the same is considered as a trade of the TM and the responsibility of settlement of such trade vests with CM of the TM.

Once confirmed by CM of concerned CP, such CM is responsible for clearing and settlement of deals of such custodial clients.

FIIs have been permitted to trade in all the exchange traded derivative contracts subject to compliance of the position limits prescribed for them and their sub-accounts, and compliance with the prescribed procedure for settlement and reporting.

A FII/ a sub-account of the FII, as the case may be, intending to trade in the F&O segment of the exchange, is required to obtain a unique Custodial Participant (CP) code allotted from the NSCCL. This is mandatory for FII/sub-accounts of FIIs to trade on the F&O segment.

3.11.11 Books of Accounts

Trading members are required to maintain the following books:

- Sauda book – a register of all transactions executed, including the name of client
- Client Register – a record of all transactions of the client with the broker
- Securities Register – a record of delivery received and made for each scrip
- Margin Deposit Register – a record of margins collected and paid
- Besides, the normal books of accounts such as Cash / Bank book, Journal Register and Ledgers are maintained
- Details of transactions of each sub-broker have to be maintained separately.

The software systems in the brokers' offices ensure that each of these is easily maintained, without repetitive data entry or processing.

3.11.12 Straight Through Processing (STP)

All the institutional trades executed on the stock exchanges have to be mandatorily processed by Straight through Processing System (STP). STP automates the entire processing from order to settlement. In the process, it integrates the entire front, middle and back offices, including accounting of transactions.

The transaction workflow in the STP system is as follows:

- A contract note in electronic form in the prescribed format (IFN 515 messaging format) is issued by the broker & sent to the custodian and / or the institutional investor.
- In case the contract note is processed directly by the institutional investor, the institutional investor sends the trade confirmation of acceptance or rejection of the contract note to the broker by using the IFN 598 messaging format. The custodian also sends the confirmation of acceptance or rejection of such contract note to the broker using the messaging standard IFN 548.
- In case the contract note is processed by the custodian on behalf of the institutional investor, the custodian sends the confirmation of acceptance or rejection of the contract note to the broker by using the IFN 548 messaging format.
- The institutional investor sends settlement instructions to its custodian in IFN 540 to IFN 543 messaging formats to the custodian for the following trade types:
 - o IFN 540: settlement instruction for a clearing house buy trade
 - o IFN 541: settlement instruction for a delivery-v/s-payment (DVP) buy trade
 - o IFN 542: settlement instruction for a clearing house sell trade
 - o IFN 543: settlement instruction for a delivery-v/s-payment (DVP) sell trade
- The custodian confirms / rejects the execution of the settlement instructions to the institutional investor in IFN 544 to IFN 547 messaging formats in the following manner:
 - o IFN 544: confirmation / rejection of an instruction received in messaging format IFN 540
 - o IFN 54+D3585: confirmation / rejection of an instruction received in messaging format IFN 541
 - o IFN 546: confirmation / rejection of an instruction received in messaging format IFN 542
 - o IFN 547: confirmation / rejection of an instruction received in messaging format IFN 543
- If a message (for the activities mentioned above) is sent using the STP centralised hub framework from one user to another user, then the confirmation / rejection for such a

message shall also be sent using the STP centralised hub framework.

STP enables orders to be processed, confirmed, cleared and settled in a shorter time period, more cost effectively and with fewer errors. Besides compressing the clearing and settlement time, STP also provides a flexible, cost-effective infrastructure, which enables e-business expansion through real-time processing and access to enterprise data. STP also streamlines back-office activities, leading to fewer failures, lower risks and drastically reduces costs per transaction.

Annexures – Uniform Documentation for Opening Trading Account

Annexure - 1			
<u>ACCOUNT OPENING KIT</u>			
<u>INDEX OF DOCUMENTS</u>			
S. No.	Name of the Document	Brief Significance of the Document	Page No
MANDATORY DOCUMENTS AS PRESCRIBED BY SEBI & EXCHANGES			
1	Account Opening Form	A. KYC form - Document captures the basic information about the constituent and an instruction/check list. B. Document captures the additional information about the constituent relevant to trading account and an instruction/check list.	
2	Rights and Obligations	Document stating the Rights & Obligations of stock broker/trading member, sub-broker and client for trading on exchanges (including additional rights & obligations in case of internet/wireless technology based trading).	
3	Risk Disclosure Document (RDD)	Document detailing risks associated with dealing in the securities market.	
4	Guidance note	Document detailing do's and don'ts for trading on exchange, for the education of the investors.	
5	Policies and Procedures	Document describing significant policies and procedures of the stock broker <i>(to be added by the stock broker)</i> .	
6	Tariff sheet	Document detailing the rate/amount of brokerage and other charges levied on the client for trading on the stock exchange(s) <i>(to be added by the stock broker)</i> .	
VOLUNTARY DOCUMENTS AS PROVIDED BY THE STOCK BROKER			
7			
8			

Name of stock broker/trading member/clearing member: _____
 SEBI Registration No. and date: _____
 Registered office address: _____
 Ph: _____ Fax: _____ Website: _____
 Correspondence office address: _____
 Ph: _____ Fax: _____ Website: _____
 Compliance officer name, phone no. & email id: _____
 CEO name, phone no. & email id: _____

For any grievance/dispute please contact stock broker (name) at the above address or email id- xxx@email.com and Phone no. 91-XXXXXXXXXX. In case not satisfied with the response, please contact the concerned exchange(s) at xyz@email.com and Phone no. 91-XXXXXXXXXX.

Annexure - 2

KNOW YOUR CLIENT (KYC) APPLICATION FORM

For Individuals

Please fill this form in **ENGLISH** and in **BLOCK LETTERS**.

PHOTOGRAPH

Please affix your recent passport size photograph and sign across it

A. IDENTITY DETAILS

1. Name of the Applicant: _____
2. Father's/ Spouse Name: _____
3. a. Gender: Male/ Female b. Marital status: Single/ Married c. Date of birth: _____ (dd/mm/yyyy)
4. a. Nationality: _____ b. Status: Resident Individual/ Non Resident/ Foreign National
5. a. PAN: _____ b. Unique Identification Number (UID)/ Aadhaar, if any: _____
6. Specify the proof of Identity submitted: _____

B. ADDRESS DETAILS

1. Address for correspondence: _____
City/town/village: _____ Pin Code: _____ State: _____ Country: _____
2. Contact Details: Tel. (Off.) _____ Tel. (Res.) _____ Mobile No.: _____ Fax: _____ Email id: _____
3. Specify the proof of address submitted for correspondence address: _____
4. Permanent Address (if different from above or overseas address, mandatory for Non-Resident Applicant): _____
City/town/village: _____ Pin Code: _____ State: _____ Country: _____
5. Specify the proof of address submitted for permanent address: _____

C. OTHER DETAILS

1. Gross Annual Income Details (please specify): Income Range per annum: Below Rs 1 Lac / 1-5 Lac / 5-10 Lac / 10-25 Lac / >25 Lacs or
Net-worth as on (date) _____ (Net worth should not be older than 1 year)
2. Occupation (please tick any one and give brief details): Private Sector/ Public Sector/ Government Service/Business/ Professional/ Agriculturist/ Retired/ Housewife/ Student/ Others _____
3. Please tick, if applicable: Politically Exposed Person (PEP)/ Related to a Politically Exposed Person (PEP)
4. Any other information: _____

DECLARATION

I hereby declare that the details furnished above are true and correct to the best of my knowledge and belief and I undertake to inform you of any changes therein, immediately. In case any of the above information is found to be false or untrue or misleading or misrepresenting, I am aware that I may be held liable for it.

Signature of the Applicant

Date: _____ (dd/mm/yyyy)

FOR OFFICE USE ONLY

- ☐ (Originals verified) True copies of documents received
- ☐ (Self-Attested) Self Certified Document copies received

(_____) Signature of the Authorised Signatory

Date _____

Seal/Stamp of the intermediary

KNOW YOUR CLIENT (KYC) APPLICATION FORM*For Non-Individuals*Please fill this form in **ENGLISH** and in **BLOCK LETTERS**.**PHOTOGRAPH**

Please affix the recent passport size photograph and sign across it

A. IDENTITY DETAILS

1. Name of the Applicant: _____
2. Date of incorporation: _____ (dd/mm/yyyy) & Place of incorporation: _____
3. Date of commencement of business: _____ (dd/mm/yyyy)
4. a. PAN: _____ b. Registration No. (e.g. CIN): _____
5. Status (please tick any one):
Private Limited Co./Public Ltd. Co./Body Corporate/Partnership/Trust/Charities/NGO's/FI/ FII/HUF/AOP/ Bank/Government Body/Non-Government Organization/Defense Establishment/BOI/Society/LLP/ Others (please specify) _____

B. ADDRESS DETAILS

1. Address for correspondence: _____
City/town/village: _____ Pin Code: _____ State: _____ Country: _____
2. Contact Details: Tel. (Off.) _____ Tel. (Res.) _____ Mobile No.: _____ Fax: _____ Email id: _____
3. Specify the proof of address submitted for correspondence address: _____
4. Registered Address (if different from above): _____
City/town/village: _____ Pin Code: _____ State: _____ Country: _____
5. Specify the proof of address submitted for registered address: _____

C. OTHER DETAILS

1. Gross Annual Income Details (please specify): Income Range per annum: Below Rs 1 Lac / 1-5 Lac / 5-10 Lac / 10-25 Lac / 25 Lacs-1 crore / > 1 crore
2. Net-worth as on (date) _____ (dd/mm/yyyy): _____ (*Net worth should not be older than 1 year)
3. Name, PAN, residential address and photographs of Promoters/Partners/Karta/Trustees and whole time directors: _____
4. DIN/UID of Promoters/Partners/Karta and whole time directors: _____
5. Please tick, if applicable, for any of your authorized signatories/Promoters/Partners/Karta/Trustees/whole time directors: Politically Exposed Person (PEP)/ Related to a Politically Exposed Person (PEP)
6. Any other information: _____

DECLARATION

I/We hereby declare that the details furnished above are true and correct to the best of my/our knowledge and belief and I/we undertake to inform you of any changes therein, immediately. In case any of the above information is found to be false or untrue or misleading or misrepresenting, I am/we are aware that I/we may be held liable for it.

Name & Signature of the Authorised Signatory

Date: _____ (dd/mm/yyyy)

FOR OFFICE USE ONLY

- ☐ (Originals verified) True copies of documents received
☐ (Self-Attested) Self Certified Document copies received

(_____) _____
Signature of the Authorised Signatory
Date _____

Seal/Stamp of the intermediary

INSTRUCTIONS/CHECK LIST FOR FILLING KYC FORM

A. IMPORTANT POINTS:

1. Self attested copy of PAN card is mandatory for all clients, including Promoters/ Partners/Karta/Trustees and whole time directors and persons authorized to deal in securities on behalf of company/firm/others.
2. Copies of all the documents submitted by the applicant should be self-attested and accompanied by originals for verification. In case the original of any document is not produced for verification, then the copies should be properly attested by entities authorized for attesting the documents, as per the below mentioned list.
3. If any proof of identity or address is in a foreign language, then translation into English is required.
4. Name & address of the applicant mentioned on the KYC form, should match with the documentary proof submitted.
5. If correspondence & permanent address are different, then proofs for both have to be submitted.
6. Sole proprietor must make the application in his individual name & capacity.
7. For non-residents and foreign nationals, (allowed to trade subject to RBI and FEMA guidelines), copy of passport/PIO Card/OCI Card and overseas address proof is mandatory.
8. For foreign entities, CIN is optional; and in the absence of DIN no. for the directors, their passport copy should be given.
9. In case of Merchant Navy NRI's, Mariner's declaration or certified copy of CDC (Continuous Discharge Certificate) is to be submitted.
10. For opening an account with Depository participant or Mutual Fund, for a minor, photocopy of the School Leaving Certificate/Mark sheet issued by Higher Secondary Board/Passport of Minor/Birth Certificate must be provided.
11. Politically Exposed Persons (PEP) are defined as individuals who are or have been entrusted with prominent public functions in a foreign country, e.g., Heads of States or of Governments, senior politicians, senior Government/judicial/ military officers, senior executives of state owned corporations, important political party officials, etc.

B. Proof of Identity (POI): - List of documents admissible as Proof of Identity:

1. Unique Identification Number (UID) (Aadhaar)/ Passport/ Voter ID card/ Driving license.
2. PAN card with photograph.

3. Identity card/ document with applicant's Photo, issued by any of the following: Central/State Government and its Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, Public Financial Institutions, Colleges affiliated to Universities, Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members; and Credit cards/Debit cards issued by Banks.

C. Proof of Address (POA): - List of documents admissible as Proof of Address:

*(*Documents having an expiry date should be valid on the date of submission.)*

1. Passport/ Voters Identity Card/ Ration Card/ Registered Lease or Sale Agreement of Residence/ Driving License/ Flat Maintenance bill/ Insurance Copy.
2. Utility bills like Telephone Bill (only land line), Electricity bill or Gas bill - Not more than 3 months old.
3. Bank Account Statement/Passbook -- Not more than 3 months old.
4. Self-declaration by High Court and Supreme Court judges, giving the new address in respect of their own accounts.
5. Proof of address issued by any of the following: Bank Managers of Scheduled Commercial Banks/Scheduled Co-Operative Bank/Multinational Foreign Banks/ Gazetted Officer/Notary public/Elected representatives to the Legislative Assembly/ Parliament/Documents issued by any Govt. or Statutory Authority.
6. Identity card/document with address, issued by any of the following: Central/ State Government and its Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, Public Financial Institutions, Colleges affiliated to Universities and Professional Bodies such as ICAI, ICWAI, ICSI, Bar Council etc., to their Members.
7. For FII/sub account, Power of Attorney given by FII/sub-account to the Custodians (which are duly notarized and/or apostiled or consularised) that gives the registered address should be taken.
8. The proof of address in the name of the spouse may be accepted.

D. Exemptions/clarifications to PAN

*(*Sufficient documentary evidence in support of such claims to be collected.)*

1. In case of transactions undertaken on behalf of Central Government and/or State Government and by officials appointed by Courts e.g. Official liquidator, Court receiver etc.
2. Investors residing in the state of Sikkim.
3. UN entities/multilateral agencies exempt from paying taxes/filing tax returns in India.

4. SIP of Mutual Funds upto Rs 50, 000/- p.a.
5. In case of institutional clients, namely, FIIs, MFs, VCFs, FVCIs, Scheduled Commercial Banks, Multilateral and Bilateral Development Financial Institutions, State Industrial Development Corporations, Insurance Companies registered with IRDA and Public Financial Institution as defined under section 4A of the Companies Act, 1956, Custodians shall verify the PAN card details with the original PAN card and provide duly certified copies of such verified PAN details to the intermediary.

E. List of people authorized to attest the documents:

1. Notary Public, Gazetted Officer, Manager of a Scheduled Commercial/ Co-operative Bank or Multinational Foreign Banks (Name, Designation & Seal should be affixed on the copy).
2. In case of NRIs, authorized officials of overseas branches of Scheduled Commercial Banks registered in India, Notary Public, Court Magistrate, Judge, Indian Embassy/ Consulate General in the country where the client resides are permitted to attest the documents.

F. In case of Non-Individuals, additional documents to be obtained from non-individuals, over & above the POI & POA, as mentioned below:

Types of entity	Documentary requirements
Corporate	<p>Copy of the balance sheets for the last 2 financial years (to be submitted every year).</p> <p>Copy of latest share holding pattern including list of all those holding control, either directly or indirectly, in the company in terms of SEBI takeover Regulations, duly certified by the company secretary/Whole time director/MD (to be submitted every year).</p> <p>Photograph, POI, POA, PAN and DIN numbers of whole time directors/two directors in charge of day to day operations.</p> <p>Photograph, POI, POA, PAN of individual promoters holding control - either directly or indirectly.</p> <p>Copies of the Memorandum and Articles of Association and certificate of incorporation.</p> <p>Copy of the Board Resolution for investment in securities market.</p> <p>Authorised signatories list with specimen signatures.</p>
Partnership firm	<p>Copy of the balance sheets for the last 2 financial years (to be submitted every year).</p> <p>Certificate of registration (for registered partnership firms only).</p> <p>Copy of partnership deed.</p> <p>Authorised signatories list with specimen signatures.</p> <p>Photograph, POI, POA, PAN of Partners.</p>

Types of entity	Documentary requirements
Trust	<p>Copy of the balance sheets for the last 2 financial years (to be submitted every year).</p> <p>Certificate of registration (for registered trust only).</p> <p>Copy of Trust deed.</p> <p>List of trustees certified by managing trustees/CA.</p> <p>Photograph, POI, POA, PAN of Trustees.</p>
HUF	<p>PAN of HUF.</p> <p>Deed of declaration of HUF/ List of coparceners.</p> <p>Bank pass-book/bank statement in the name of HUF.</p> <p>Photograph, POI, POA, PAN of Karta.</p>
Unincorporated association or a body of individuals	<p>Proof of Existence/Constitution document.</p> <p>Resolution of the managing body & Power of Attorney granted to transact business on its behalf.</p> <p>Authorized signatories list with specimen signatures.</p>
Banks/ Institutional Investors	<p>Copy of the constitution/registration or annual report/balance sheet for the last 2 financial years.</p> <p>Authorized signatories list with specimen signatures.</p>
Foreign Institutional Investors (FII)	<p>Copy of SEBI registration certificate.</p> <p>Authorized signatories list with specimen signatures.</p>
Army/ Government Bodies	<p>Self-certification on letterhead.</p> <p>Authorized signatories list with specimen signatures.</p>
Registered Society	<p>Copy of Registration Certificate under Societies Registration Act.</p> <p>List of Managing Committee members.</p> <p>Committee resolution for persons authorised to act as authorised signatories with specimen signatures.</p> <p>True copy of Society Rules and Bye Laws certified by the Chairman/ Secretary</p>

Annexure – 3

TRADING ACCOUNT RELATED DETAILS

For Individuals & Non-individuals

A. BANK ACCOUNT(S) DETAILS

Bank Name	Branch address	Bank account no.	Account Type: Saving/Current/ Others-In case of NRI/NRE/NRO	MICR Number	IFSC code

B. DEPOSITORY ACCOUNT(S) DETAILS

Depository Participant Name	Depository Name (NSDL/CDSL)	Beneficiary name	DP ID	Beneficiary ID (BO ID)

C. TRADING PREFERENCES

**Please sign in the relevant boxes where you wish to trade. The segment not chosen should be struck off by the client.*

Exchanges	Segments			
Name of the Exchange -1	Cash		Currency Derivative	
	F&O		Name of other Segment s, if any	
Name of the Exchange -2	Name of the Segments -1, 2...			

If, in future, the client wants to trade on any new segment/new exchange, separate authorization/letter should be taken from the client by the stock broker.

D. PAST ACTIONS

- Details of any action/proceedings initiated/pending/ taken by SEBI/ Stock exchange/any other authority against the applicant/constituent or its Partners/promoters/whole time directors/authorized persons in charge of dealing in securities during the last 3 years:

E. DEALINGS THROUGH SUB-BROKERS AND OTHER STOCK BROKERS

- If client is dealing through the sub-broker, provide the following details:
Sub-broker's Name: SEBI Registration number:
Registered office address: Ph: Fax: Website:
- Whether dealing with any other stock broker/sub-broker (if case dealing with multiple stock brokers/sub-brokers, provide details of all)
Name of stock broker: Name of Sub-Broker, if any:
Client Code: Exchange:
Details of disputes/dues pending from/to such stock broker/sub- broker:

F. ADDITIONAL DETAILS

- Whether you wish to receive physical contract note or Electronic Contract Note (ECN) (please specify):
Specify your Email id, if applicable:
- Whether you wish to avail of the facility of internet trading/ wireless technology (please specify):
- Number of years of Investment/Trading Experience:
- In case of non-individuals, name, designation, PAN, UID, signature, residential address and photographs of persons authorized to deal in securities on behalf of company/firm/others:
- Any other information:

C. INTRODUCER DETAILS (optional)

Name of the Introducer:
 (Surname) (Name) (Middle Name)
 Status of the Introducer: Sub-broker/Remisier/Authorized Person/Existing Client/Others, please specify.....
 Address and phone no. of the Introducer: Signature of the Introducer:

☐ I/We wish to nominate ☐ I/We do not wish to nominate
 Name of the Nominee: Relationship with the Nominee:
 PAN of Nominee: Date of Birth of Nominee:
 Address and phone no. of the Nominee:

Name of guardian: Address and phone no. of Guardian:
Signature of guardian:

WITNESSES (Only applicable in case the account holder has made nomination)

Name _____	Name _____
Signature _____	Signature _____
Address _____	Address _____

1. I/We hereby declare that the details furnished above are true and correct to the best of my/our knowledge and belief and I/we undertake to inform you of any changes therein, immediately. In case any of the above information is found to be false or untrue or misleading or misrepresenting, I am/we are aware that I/we may be held liable for it.
2. I/We confirm having read/been explained and understood the contents of the document on policy and procedures of the stock broker and the tariff sheet.
3. I/We further confirm having read and understood the contents of the 'Rights and Obligations' document(s) and 'Risk Disclosure Document'. I/We do hereby agree to be bound by such provisions as outlined in these documents. I/We have also been informed that the standard set of documents has been displayed for Information on stock broker's designated website, if any.

(-----)
Signature of Client/ (all) Authorized Signatory (ies)

FOR OFFICE USE ONLY

UCC Code allotted to the Client: _____

	Documents verified with Originals	Client Interviewed By	In-Person Verification done by
Name of the Employee			
Employee Code			
Designation of the employee			
Date			
Signature			

I / We undertake that we have made the client aware of 'Policy and Procedures', tariff sheet and all the non-mandatory documents. I/We have also made the client aware of 'Rights and Obligations' document (s), RDD and Guidance Note. I/We have given/sent him a copy of all the KYC documents. I/We undertake that any change in the 'Policy and Procedures', tariff sheet and all the non-mandatory documents would be duly intimated to the clients. I/We also undertake that any change in the 'Rights and Obligations' and RDD would be made available on my/our website, if any, for the information of the clients.

Signature of the Authorised Signatory

Date

Seal/Stamp of the stock broker

INSTRUCTIONS/ CHECK LIST

1. Additional documents in case of trading in derivatives segments - illustrative list:

Copy of ITR Acknowledgement	Copy of Annual Accounts
In case of salary income - Salary Slip, Copy of Form 16	Net worth certificate
Copy of demat account holding statement.	Bank account statement for last 6 months
Any other relevant documents substantiating ownership of assets.	Self declaration with relevant supporting documents.

**In respect of other clients, documents as per risk management policy of the stock broker need to be provided by the client from time to time.*

2. Copy of cancelled cheque leaf/ pass book/bank statement specifying name of the constituent, MICR Code or/and IFSC Code of the bank should be submitted.
3. Demat master or recent holding statement issued by DP bearing name of the client.
4. For individuals:
 - a. Stock broker has an option of doing 'in-person' verification through web camera at the branch office of the stock broker/sub-broker's office.
 - b. In case of non-resident clients, employees at the stock broker's local office, overseas can do in-person' verification. Further, considering the infeasibility of carrying out 'In-person' verification of the non-resident clients by the stock broker's staff, attestation of KYC documents by Notary Public, Court, Magistrate, Judge, Local Banker, Indian Embassy / Consulate General in the country where the client resides may be permitted.
5. For non-individuals:
 - a. Form need to be initialized by all the authorized signatories.
 - b. Copy of Board Resolution or declaration (on the letterhead) naming the persons authorized to deal in securities on behalf of company/firm/others and their specimen signatures.

Annexure – 4

RIGHTS AND OBLIGATIONS OF STOCK BROKERS, SUB-BROKERS AND CLIENTS *as prescribed by SEBI and Stock Exchanges*

1. The client shall invest/trade in those securities/contracts/other instruments admitted to dealings on the Exchanges as defined in the Rules, Byelaws and Regulations of Exchanges/ Securities and Exchange Board of India (SEBI) and circulars/notices issued there under from time to time.
2. The stock broker, sub-broker and the client shall be bound by all the Rules, Byelaws and Regulations of the Exchange and circulars/notices issued there under and Rules and Regulations of SEBI and relevant notifications of Government authorities as may be in force from time to time.
3. The client shall satisfy itself of the capacity of the stock broker to deal in securities and/or deal in derivatives contracts and wishes to execute its orders through the stock broker and the client shall from time to time continue to satisfy itself of such capability of the stock broker before executing orders through the stock broker.
4. The stock broker shall continuously satisfy itself about the genuineness and financial soundness of the client and investment objectives relevant to the services to be provided.
5. The stock broker shall take steps to make the client aware of the precise nature of the Stock broker's liability for business to be conducted, including any limitations, the liability and the capacity in which the stock broker acts.
6. The sub-broker shall provide necessary assistance and co-operate with the stock broker in all its dealings with the client(s).

CLIENT INFORMATION

7. The client shall furnish all such details in full as are required by the stock broker in "Account Opening Form" with supporting details, made mandatory by stock exchanges/ SEBI from time to time.
8. The client shall familiarize himself with all the mandatory provisions in the Account Opening documents. Any additional clauses or documents specified by the stock broker shall be non-mandatory, as per terms & conditions accepted by the client.
9. The client shall immediately notify the stock broker in writing if there is any change in the information in the 'account opening form' as provided at the time of account opening and thereafter; including the information on winding up petition/insolvency petition or any litigation which may have material bearing on his capacity. The client shall provide/update the financial information to the stock broker on a periodic basis.
10. The stock broker and sub-broker shall maintain all the details of the client as mentioned in the account opening form or any other information pertaining to the

client, confidentially and that they shall not disclose the same to any person/authority except as required under any law/regulatory requirements. Provided however that the stock broker may so disclose information about his client to any person or authority with the express permission of the client.

MARGINS

11. The client shall pay applicable initial margins, withholding margins, special margins or such other margins as are considered necessary by the stock broker or the Exchange or as may be directed by SEBI from time to time as applicable to the segment(s) in which the client trades. The stock broker is permitted in its sole and absolute discretion to collect additional margins (even though not required by the Exchange, Clearing House/ Clearing Corporation or SEBI) and the client shall be obliged to pay such margins within the stipulated time.
12. The client understands that payment of margins by the client does not necessarily imply complete satisfaction of all dues. In spite of consistently having paid margins, the client may, on the settlement of its trade, be obliged to pay (or entitled to receive) such further sums as the contract may dictate/require.

TRANSACTIONS AND SETTLEMENTS

13. The client shall give any order for buy or sell of a security/derivatives contract in writing or in such form or manner, as may be mutually agreed between the client and the stock broker. The stock broker shall ensure to place orders and execute the trades of the client, only in the Unique Client Code assigned to that client.
14. The stock broker shall inform the client and keep him apprised about trading/settlement cycles, delivery/payment schedules, any changes therein from time to time, and it shall be the responsibility in turn of the client to comply with such schedules/procedures of the relevant stock exchange where the trade is executed.
15. The stock broker shall ensure that the money/securities deposited by the client shall be kept in a separate account, distinct from his/its own account or account of any other client and shall not be used by the stock broker for himself/itself or for any other client or for any purpose other than the purposes mentioned in Rules, Regulations, circulars, notices, guidelines of SEBI and/or Rules, Regulations, Bye-laws, circulars and notices of Exchange.
16. Where the Exchange(s) cancels trade(s) suo moto all such trades including the trade/s done on behalf of the client shall ipso facto stand cancelled, stock broker shall be entitled to cancel the respective contract(s) with client(s).
17. The transactions executed on the Exchange are subject to Rules, Byelaws and Regulations and circulars/notices issued thereunder of the Exchanges where the trade is executed and all parties to such trade shall have submitted to the jurisdiction of such court as

may be specified by the Byelaws and Regulations of the Exchanges where the trade is executed for the purpose of giving effect to the provisions of the Rules, Byelaws and Regulations of the Exchanges and the circulars/notices issued thereunder.

BROKERAGE

18. The Client shall pay to the stock broker brokerage and statutory levies as are prevailing from time to time and as they apply to the Client's account, transactions and to the services that stock broker renders to the Client. The stock broker shall not charge brokerage more than the maximum brokerage permissible as per the rules, regulations and bye-laws of the relevant stock exchanges and/or rules and regulations of SEBI.

LIQUIDATION AND CLOSE OUT OF POSITION

19. Without prejudice to the stock broker's other rights (including the right to refer a matter to arbitration), the client understands that the stock broker shall be entitled to liquidate/close out all or any of the client's positions for non-payment of margins or other amounts, outstanding debts, etc. and adjust the proceeds of such liquidation/close out, if any, against the client's liabilities/obligations. Any and all losses and financial charges on account of such liquidation/closing-out shall be charged to and borne by the client.
20. In the event of death or insolvency of the client or his/its otherwise becoming incapable of receiving and paying for or delivering or transferring securities which the client has ordered to be bought or sold, stock broker may close out the transaction of the client and claim losses, if any, against the estate of the client. The client or his nominees, successors, heirs and assignee shall be entitled to any surplus which may result there from. The client shall note that transfer of funds/securities in favor of a Nominee shall be valid discharge by the stock broker against the legal heir.
21. The stock broker shall bring to the notice of the relevant Exchange the information about default in payment/delivery and related aspects by a client. In case where defaulting client is a corporate entity/partnership/proprietary firm or any other artificial legal entity, then the name(s) of Director(s)/Promoter(s)/Partner(s)/Proprietor as the case may be, shall also be communicated by the stock broker to the relevant Exchange(s).

DISPUTE RESOLUTION

22. The stock broker shall provide the client with the relevant contact details of the concerned Exchanges and SEBI.
23. The stock broker shall co-operate in redressing grievances of the client in respect of all transactions routed through it and in removing objections for bad delivery of shares, rectification of bad delivery, etc.
24. The client and the stock broker shall refer any claims and/or disputes with respect to deposits, margin money, etc., to arbitration as per the Rules, Byelaws and Regulations

of the Exchanges where the trade is executed and circulars/notices issued thereunder as may be in force from time to time.

25. The stock broker shall ensure faster settlement of any arbitration proceedings arising out of the transactions entered into between him vis-à-vis the client and he shall be liable to implement the arbitration awards made in such proceedings.
26. The client/stock-broker understands that the instructions issued by an authorized representative for dispute resolution, if any, of the client/stock-broker shall be binding on the client/stock-broker in accordance with the letter authorizing the said representative to deal on behalf of the said client/stock-broker.

TERMINATION OF RELATIONSHIP

27. This relationship between the stock broker and the client shall be terminated; if the stock broker for any reason ceases to be a member of the stock exchange including cessation of membership by reason of the stock broker's default, death, resignation or expulsion or if the certificate is cancelled by the Board.
28. The stock broker, sub-broker and the client shall be entitled to terminate the relationship between them without giving any reasons to the other party, after giving notice in writing of not less than one month to the other parties. Notwithstanding any such termination, all rights, liabilities and obligations of the parties arising out of or in respect of transactions entered into prior to the termination of this relationship shall continue to subsist and vest in/be binding on the respective parties or his/its respective heirs, executors, administrators, legal representatives or successors, as the case may be.
29. In the event of demise/insolvency of the sub-broker or the cancellation of his/its registration with the Board or/withdrawal of recognition of the sub-broker by the stock exchange and/or termination of the agreement with the sub broker by the stock broker, for any reason whatsoever, the client shall be informed of such termination and the client shall be deemed to be the direct client of the stock broker and all clauses in the 'Rights and Obligations' document(s) governing the stock broker, sub-broker and client shall continue to be in force as it is, unless the client intimates to the stock broker his/its intention to terminate their relationship by giving a notice in writing of not less than one month.

ADDITIONAL RIGHTS AND OBLIGATIONS

30. The stock broker shall ensure due protection to the client regarding client's rights to dividends, rights or bonus shares, etc. in respect of transactions routed through it and it shall not do anything which is likely to harm the interest of the client with whom and for whom they may have had transactions in securities.
31. The stock broker and client shall reconcile and settle their accounts from time to time as per the Rules, Regulations, Bye Laws, Circulars, Notices and Guidelines issued by

SEBI and the relevant Exchanges where the trade is executed.

32. The stock broker shall issue a contract note to his constituents for trades executed in such format as may be prescribed by the Exchange from time to time containing records of all transactions including details of order number, trade number, trade time, trade price, trade quantity, details of the derivatives contract, client code, brokerage, all charges levied etc. and with all other relevant details as required therein to be filled in and issued in such manner and within such time as prescribed by the Exchange. The stock broker shall send contract notes to the investors within one working day of the execution of the trades in hard copy and/or in electronic form using digital signature.
33. The stock broker shall make pay out of funds or delivery of securities, as the case may be, to the Client within one working day of receipt of the payout from the relevant Exchange where the trade is executed unless otherwise specified by the client and subject to such terms and conditions as may be prescribed by the relevant Exchange from time to time where the trade is executed.
34. The stock broker shall send a complete 'Statement of Accounts' for both funds and securities in respect of each of its clients in such periodicity and format within such time, as may be prescribed by the relevant Exchange, from time to time, where the trade is executed. The Statement shall also state that the client shall report errors, if any, in the Statement within such time as may be prescribed by the relevant Exchange from time to time where the trade was executed, from the receipt thereof to the Stock broker.
35. The stock broker shall send daily margin statements to the clients. Daily Margin statement should include, inter-alia, details of collateral deposited, collateral utilized and collateral status (available balance/due from client) with break up in terms of cash, Fixed Deposit Receipts (FDRs), Bank Guarantee and securities.
36. The Client shall ensure that it has the required legal capacity to, and is authorized to, enter into the relationship with stock broker and is capable of performing his obligations and undertakings hereunder. All actions required to be taken to ensure compliance of all the transactions, which the Client may enter into shall be completed by the Client prior to such transaction being entered into.

ELECTRONIC CONTRACT NOTES (ECN)

37. In case, client opts to receive the contract note in electronic form, he shall provide an appropriate e-mail id to the stock broker. The client shall communicate to the stock broker any change in the email-id through a physical letter. If the client has opted for internet trading, the request for change of email id may be made through the secured access by way of client specific user id and password.
38. The stock broker shall ensure that all ECNs sent through the e-mail shall be digitally signed, encrypted, non-tamper able and in compliance with the provisions of the IT

Act, 2000. In case, ECN is sent through e-mail as an attachment, the attached file shall also be secured with the digital signature, encrypted and non-tamperable.

39. The client shall note that non-receipt of bounced mail notification by the stock broker shall amount to delivery of the contract note at the e-mail ID of the client.
40. The stock broker shall retain ECN and acknowledgement of the e-mail in a soft and non-tamperable form in the manner prescribed by the exchange in compliance with the provisions of the IT Act, 2000 and as per the extant rules/regulations/circulars/guidelines issued by SEBI/Stock Exchanges from time to time. The proof of delivery i.e., log report generated by the system at the time of sending the contract notes shall be maintained by the stock broker for the specified period under the extant regulations of SEBI/stock exchanges. The log report shall provide the details of the contract notes that are not delivered to the client/e-mails rejected or bounced back. The stock broker shall take all possible steps to ensure receipt of notification of bounced mails by him at all times within the stipulated time period under the extant regulations of SEBI/stock exchanges.
41. The stock broker shall continue to send contract notes in the physical mode to such clients who do not opt to receive the contract notes in the electronic form. Wherever the ECNs have not been delivered to the client or has been rejected (bouncing of mails) by the e-mail ID of the client, the stock broker shall send a physical contract note to the client within the stipulated time under the extant regulations of SEBI/stock exchanges and maintain the proof of delivery of such physical contract notes.
42. In addition to the e-mail communication of the ECNs to the client, the stock broker shall simultaneously publish the ECN on his designated web-site, if any, in a secured way and enable relevant access to the clients and for this purpose, shall allot a unique user name and password to the client, with an option to the client to save the contract note electronically and/or take a print out of the same.

LAW AND JURISDICTION

43. In addition to the specific rights set out in this document, the stock broker, sub-broker and the client shall be entitled to exercise any other rights which the stock broker or the client may have under the Rules, Bye-laws and Regulations of the Exchanges in which the client chooses to trade and circulars/notices issued there under or Rules and Regulations of SEBI.
44. The provisions of this document shall always be subject to Government notifications, any rules, regulations, guidelines and circulars/notices issued by SEBI and Rules, Regulations and Bye laws of the relevant stock exchanges, where the trade is executed, that may be in force from time to time.

45. The stock broker and the client shall abide by any award passed by the Arbitrator(s) under the Arbitration and Conciliation Act, 1996. However, there is also a provision of appeal within the stock exchanges, if either party is not satisfied with the arbitration award.
46. Words and expressions which are used in this document but which are not defined herein shall, unless the context otherwise requires, have the same meaning as assigned thereto in the Rules, Byelaws and Regulations and circulars/notices issued there under of the Exchanges/SEBI.
47. All additional voluntary clauses/document added by the stock broker should not be in contravention with rules/regulations/notices/circulars of Exchanges/SEBI. Any changes in such voluntary clauses/document(s) need to be preceded by a notice of 15 days. Any changes in the rights and obligations which are specified by Exchanges/SEBI shall also be brought to the notice of the clients.
48. If the rights and obligations of the parties hereto are altered by virtue of change in Rules and regulations of SEBI or Bye-laws, Rules and Regulations of the relevant stock Exchanges where the trade is executed, such changes shall be deemed to have been incorporated herein in modification of the rights and obligations of the parties mentioned in this document.

INTERNET & WIRELESS TECHNOLOGY BASED TRADING FACILITY PROVIDED BY STOCK BROKERS TO CLIENT

(All the clauses mentioned in the '*Rights and Obligations*' document(s) shall be applicable. Additionally, the clauses mentioned herein shall also be applicable.)

1. Stock broker is eligible for providing Internet based trading (IBT) and securities trading through the use of wireless technology that shall include the use of devices such as mobile phone, laptop with data card, etc. which use Internet Protocol (IP). The stock broker shall comply with all requirements applicable to internet based trading/securities trading using wireless technology as may be specified by SEBI & the Exchanges from time to time.
2. The client is desirous of investing/trading in securities and for this purpose, the client is desirous of using either the internet based trading facility or the facility for securities trading through use of wireless technology. The Stock broker shall provide the Stock broker's IBT Service to the Client, and the Client shall avail of the Stock broker's IBT Service, on and subject to SEBI/Exchanges Provisions and the terms and conditions specified on the Stock broker's IBT Web Site provided that they are in line with the norms prescribed by Exchanges/SEBI.
3. The stock broker shall bring to the notice of client the features, risks, responsibilities, obligations and liabilities associated with securities trading through wireless technology/

internet/smart order routing or any other technology should be brought to the notice of the client by the stock broker.

4. The stock broker shall make the client aware that the Stock Broker's IBT system itself generates the initial password and its password policy as stipulated in line with norms prescribed by Exchanges/SEBI.
5. The Client shall be responsible for keeping the Username and Password confidential and secure and shall be solely responsible for all orders entered and transactions done by any person whosoever through the Stock broker's IBT System using the Client's Username and/or Password whether or not such person was authorized to do so. Also the client is aware that authentication technologies and strict security measures are required for the internet trading/securities trading through wireless technology through order routed system and undertakes to ensure that the password of the client and/or his authorized representative are not revealed to any third party including employees and dealers of the stock broker
6. The Client shall immediately notify the Stock broker in writing if he forgets his password, discovers security flaw in Stock Broker's IBT System, discovers/suspects discrepancies/unauthorized access through his username/password/account with full details of such unauthorized use, the date, the manner and the transactions effected pursuant to such unauthorized use, etc.
7. The Client is fully aware of and understands the risks associated with availing of a service for routing orders over the internet/securities trading through wireless technology and Client shall be fully liable and responsible for any and all acts done in the Client's Username/password in any manner whatsoever.
8. The stock broker shall send the order/trade confirmation through email to the client at his request. The client is aware that the order/ trade confirmation is also provided on the web portal. In case client is trading using wireless technology, the stock broker shall send the order/trade confirmation on the device of the client.
9. The client is aware that trading over the internet involves many uncertain factors and complex hardware, software, systems, communication lines, peripherals, etc. are susceptible to interruptions and dislocations. The Stock broker and the Exchange do not make any representation or warranty that the Stock broker's IBT Service will be available to the Client at all times without any interruption.
10. The Client shall not have any claim against the Exchange or the Stock broker on account of any suspension, interruption, non-availability or malfunctioning of the Stock broker's IBT System or Service or the Exchange's service or systems or non-execution of his orders due to any link/system failure at the Client/Stock brokers/Exchange end for any reason beyond the control of the stock broker/Exchanges.

Annexure – 5

RISK DISCLOSURE DOCUMENT FOR CAPITAL MARKET AND DERIVATIVES SEGMENTS

This document contains important information on trading in Equities/Derivatives Segments of the stock exchanges. All prospective constituents should read this document before trading in Equities/Derivatives Segments of the Exchanges.

Stock exchanges/SEBI does neither singly or jointly and expressly nor impliedly guarantee nor make any representation concerning the completeness, the adequacy or accuracy of this disclosure document nor have Stock exchanges /SEBI endorsed or passed any merits of participating in the trading segments. This brief statement does not disclose all the risks and other significant aspects of trading.

In the light of the risks involved, you should undertake transactions only if you understand the nature of the relationship into which you are entering and the extent of your exposure to risk.

You must know and appreciate that trading in Equity shares, derivatives contracts or other instruments traded on the Stock Exchange, which have varying element of risk, is generally not an appropriate avenue for someone of limited resources/limited investment and/or trading experience and low risk tolerance. You should therefore carefully consider whether such trading is suitable for you in the light of your financial condition. In case you trade on Stock exchanges and suffer adverse consequences or loss, you shall be solely responsible for the same and Stock exchanges/its Clearing Corporation and/or SEBI shall not be responsible, in any manner whatsoever, for the same and it will not be open for you to take a plea that no adequate disclosure regarding the risks involved was made or that you were not explained the full risk involved by the concerned stock broker. The constituent shall be solely responsible for the consequences and no contract can be rescinded on that account. You must acknowledge and accept that there can be no guarantee of profits or no exception from losses while executing orders for purchase and/or sale of a derivative contract being traded on Stock exchanges.

It must be clearly understood by you that your dealings on Stock exchanges through a stock broker shall be subject to your fulfilling certain formalities set out by the stock broker, which may inter alia include your filling the know your client form, reading the rights and obligations, do's and don'ts, etc., and are subject to the Rules, Byelaws and Regulations of relevant Stock exchanges, its Clearing Corporation, guidelines prescribed by SEBI and in force from time to time and Circulars as may be issued by Stock exchanges or its Clearing Corporation and in force from time to time.

Stock exchanges does not provide or purport to provide any advice and shall not be liable to any person who enters into any business relationship with any stock broker of Stock exchanges and/or any third party based on any information contained in this document.

Any information contained in this document must not be construed as business advice. No consideration to trade should be made without thoroughly understanding and reviewing the risks involved in such trading. If you are unsure, you must seek professional advice on the same.

In considering whether to trade or authorize someone to trade for you, you should be aware of or must get acquainted with the following:-

1. BASIC RISKS:

1.1 Risk of Higher Volatility:

Volatility refers to the dynamic changes in price that a security/derivatives contract undergoes when trading activity continues on the Stock Exchanges. Generally, higher the volatility of a security/derivatives contract, greater is its price swings. There may be normally greater volatility in thinly traded securities / derivatives contracts than in active securities /derivatives contracts. As a result of volatility, your order may only be partially executed or not executed at all, or the price at which your order got executed may be substantially different from the last traded price or change substantially thereafter, resulting in notional or real losses.

1.2 Risk of Lower Liquidity:

Liquidity refers to the ability of market participants to buy and/or sell securities / derivatives contracts expeditiously at a competitive price and with minimal price difference. Generally, it is assumed that more the numbers of orders available in a market, greater is the liquidity. Liquidity is important because with greater liquidity, it is easier for investors to buy and/or sell securities / derivatives contracts swiftly and with minimal price difference, and as a result, investors are more likely to pay or receive a competitive price for securities / derivatives contracts purchased or sold. There may be a risk of lower liquidity in some securities / derivatives contracts as compared to active securities / derivatives contracts. As a result, your order may only be partially executed, or may be executed with relatively greater price difference or may not be executed at all.

1.2.1 Buying or selling securities / derivatives contracts as part of a day trading strategy may also result into losses, because in such a situation, securities / derivatives contracts may have to be sold / purchased at low / high prices, compared to the expected price levels, so as not to have any open position or obligation to deliver or receive a security / derivatives contract.

1.3 Risk of Wider Spreads:

Spread refers to the difference in best buy price and best sell price. It represents the differential between the price of buying a security / derivatives contract and immediately selling it or vice versa. Lower liquidity and higher volatility may result in wider than normal

spreads for less liquid or illiquid securities / derivatives contracts. This in turn will hamper better price formation.

1.4 Risk-reducing orders:

The placing of orders (e.g., "stop loss" orders, or "limit" orders) which are intended to limit losses to certain amounts may not be effective many a time because rapid movement in market conditions may make it impossible to execute such orders.

1.4.1 A "market" order will be executed promptly, subject to availability of orders on opposite side, without regard to price and that, while the customer may receive a prompt execution of a "market" order, the execution may be at available prices of outstanding orders, which satisfy the order quantity, on price time priority. It may be understood that these prices may be significantly different from the last traded price or the best price in that security / derivatives contract.

1.4.2 A "limit" order will be executed only at the "limit" price specified for the order or a better price. However, while the customer receives price protection, there is a possibility that the order may not be executed at all.

1.4.3 A stop loss order is generally placed "away" from the current price of a stock / derivatives contract, and such order gets activated if and when the security / derivatives contract reaches, or trades through, the stop price. Sell stop orders are entered ordinarily below the current price, and buy stop orders are entered ordinarily above the current price. When the security / derivatives contract reaches the pre-determined price, or trades through such price, the stop loss order converts to a market/limit order and is executed at the limit or better. There is no assurance therefore that the limit order will be executable since a security / derivatives contract might penetrate the pre-determined price, in which case, the risk of such order not getting executed arises, just as with a regular limit order.

1.5 Risk of News Announcements:

News announcements that may impact the price of stock / derivatives contract may occur during trading, and when combined with lower liquidity and higher volatility, may suddenly cause an unexpected positive or negative movement in the price of the security / contract.

1.6 Risk of Rumors:

Rumors about companies / currencies at times float in the market through word of mouth, newspapers, websites or news agencies, etc. The investors should be wary of and should desist from acting on rumors.

1.7 System Risk:

High volume trading will frequently occur at the market opening and before market close. Such high volumes may also occur at any point in the day. These may cause delays in order execution or confirmation.

1.7.1 During periods of volatility, on account of market participants continuously modifying their order quantity or prices or placing fresh orders, there may be delays in order execution and its confirmations.

1.7.2 Under certain market conditions, it may be difficult or impossible to liquidate a position in the market at a reasonable price or at all, when there are no outstanding orders either on the buy side or the sell side, or if trading is halted in a security / derivatives contract due to any action on account of unusual trading activity or security / derivatives contract hitting circuit filters or for any other reason.

1.8 System/Network Congestion:

Trading on exchanges is in electronic mode, based on satellite/leased line based communications, combination of technologies and computer systems to place and route orders. Thus, there exists a possibility of communication failure or system problems or slow or delayed response from system or trading halt, or any such other problem/glitch whereby not being able to establish access to the trading system/network, which may be beyond control and may result in delay in processing or not processing buy or sell orders either in part or in full. You are cautioned to note that although these problems may be temporary in nature, but when you have outstanding open positions or unexecuted orders, these represent a risk because of your obligations to settle all executed transactions.

2. As far as Derivatives segments are concerned, please note and get yourself acquainted with the following additional features:-

2.1 Effect of “Leverage” or “Gearing”:

In the derivatives market, the amount of margin is small relative to the value of the derivatives contract so the transactions are 'leveraged' or 'geared'. Derivatives trading, which is conducted with a relatively small amount of margin, provides the possibility of great profit or loss in comparison with the margin amount. But transactions in derivatives carry a high degree of risk.

You should therefore completely understand the following statements before actually trading in derivatives and also trade with caution while taking into account one's circumstances, financial resources, etc. If the prices move against you, you may lose a part of or whole margin amount in a relatively short period of time. Moreover, the loss may exceed the original margin amount.

- A. Futures trading involve daily settlement of all positions. Every day the open positions are marked to market based on the closing level of the index / derivatives contract. If the contract has moved against you, you will be required to deposit the amount of loss (notional) resulting from such movement. This amount will have to be paid within a stipulated time frame, generally before commencement of trading on next day.

- B. If you fail to deposit the additional amount by the deadline or if an outstanding debt occurs in your account, the stock broker may liquidate a part of or the whole position or substitute securities. In this case, you will be liable for any losses incurred due to such close-outs.
- C. Under certain market conditions, an investor may find it difficult or impossible to execute transactions. For example, this situation can occur due to factors such as illiquidity i.e. when there are insufficient bids or offers or suspension of trading due to price limit or circuit breakers etc.
- D. In order to maintain market stability, the following steps may be adopted: changes in the margin rate, increases in the cash margin rate or others. These new measures may also be applied to the existing open interests. In such conditions, you will be required to put up additional margins or reduce your positions.
- E. You must ask your broker to provide the full details of derivatives contracts you plan to trade i.e. the contract specifications and the associated obligations.

2.2 Currency specific risks:

- 1. The profit or loss in transactions in foreign currency-denominated contracts, whether they are traded in your own or another jurisdiction, will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the contract to another currency.
- 2. Under certain market conditions, you may find it difficult or impossible to liquidate a position. This can occur, for example when a currency is deregulated or fixed trading bands are widened.
- 3. Currency prices are highly volatile. Price movements for currencies are influenced by, among other things: changing supply-demand relationships; trade, fiscal, monetary, exchange control programs and policies of governments; foreign political and economic events and policies; changes in national and international interest rates and inflation; currency devaluation; and sentiment of the market place. None of these factors can be controlled by any individual advisor and no assurance can be given that an advisor's advice will result in profitable trades for a participating customer or that a customer will not incur losses from such events.

2.3 Risk of Option holders:

- 1. An option holder runs the risk of losing the entire amount paid for the option in a relatively short period of time. This risk reflects the nature of an option as a wasting asset which becomes worthless when it expires. An option holder who neither sells his option in the secondary market nor exercises it prior to its expiration will necessarily lose his entire investment in the option. If the price of the underlying does not change

in the anticipated direction before the option expires, to an extent sufficient to cover the cost of the option, the investor may lose all or a significant part of his investment in the option.

2. The Exchanges may impose exercise restrictions and have absolute authority to restrict the exercise of options at certain times in specified circumstances.

2.4 Risks of Option Writers:

1. If the price movement of the underlying is not in the anticipated direction, the option writer runs the risks of losing substantial amount.
2. The risk of being an option writer may be reduced by the purchase of other options on the same underlying interest and thereby assuming a spread position or by acquiring other types of hedging positions in the options markets or other markets. However, even where the writer has assumed a spread or other hedging position, the risks may still be significant. A spread position is not necessarily less risky than a simple 'long' or 'short' position.
3. Transactions that involve buying and writing multiple options in combination, or buying or writing options in combination with buying or selling short the underlying interests, present additional risks to investors. Combination transactions, such as option spreads, are more complex than buying or writing a single option. And it should be further noted that, as in any area of investing, a complexity not well understood is, in itself, a risk factor. While this is not to suggest that combination strategies should not be considered, it is advisable, as is the case with all investments in options, to consult with someone who is experienced and knowledgeable with respect to the risks and potential rewards of combination transactions under various market circumstances.

3. TRADING THROUGH WIRELESS TECHNOLOGY/ SMART ORDER ROUTING OR ANY OTHER TECHNOLOGY:

Any additional provisions defining the features, risks, responsibilities, obligations and liabilities associated with securities trading through wireless technology/ smart order routing or any other technology should be brought to the notice of the client by the stock broker.

4. GENERAL

4.1 The term 'constituent' shall mean and include a client, a customer or an investor, who deals with a stock broker for the purpose of acquiring and/or selling of securities / derivatives contracts through the mechanism provided by the Exchanges.

4.2 The term 'stock broker' shall mean and include a stock broker, a broker or a stock broker, who has been admitted as such by the Exchanges and who holds a registration certificate from SEBI.

Annexure-6

GUIDANCE NOTE - DO's AND DON'Ts FOR TRADING ON THE EXCHANGE(S) FOR INVESTORS

BEFORE YOU BEGIN TO TRADE

1. Ensure that you deal with and through only SEBI registered intermediaries. You may check their SEBI registration certificate number from the list available on the Stock exchanges www.exchange.com and SEBI website www.sebi.gov.in.
2. Ensure that you fill the KYC form completely and strike off the blank fields in the KYC form.
3. Ensure that you have read all the mandatory documents viz. Rights and Obligations, Risk Disclosure Document, Policy and Procedure document of the stock broker.
4. Ensure to read, understand and then sign the voluntary clauses, if any, agreed between you and the stock broker. Note that the clauses as agreed between you and the stock broker cannot be changed without your consent.
5. Get a clear idea about all brokerage, commissions, fees and other charges levied by the broker on you for trading and the relevant provisions/ guidelines specified by SEBI/Stock exchanges.
6. Obtain a copy of all the documents executed by you from the stock broker free of charge.
7. In case you wish to execute Power of Attorney (POA) in favour of the Stock broker, authorizing it to operate your bank and demat account, please refer to the guidelines issued by SEBI/Exchanges in this regard.

TRANSACTIONS AND SETTLEMENTS

8. The stock broker may issue electronic contract notes (ECN) if specifically authorized by you in writing. You should provide your email id to the stock broker for the same. Don't opt for ECN if you are not familiar with computers.
9. Don't share your internet trading account's password with anyone.
10. Don't make any payment in cash to the stock broker.
11. Make the payments by account payee cheque in favour of the stock broker. Don't issue cheques in the name of sub-broker. Ensure that you have a documentary proof of your payment/deposit of securities with the stock broker, stating date, scrip, quantity, towards which bank/ demat account such money or securities deposited and from which bank/ demat account.
12. Note that facility of Trade Verification is available on stock exchanges' websites, where details of trade as mentioned in the contract note may be verified. Where trade details on the website do not tally with the details mentioned in the contract note, immediately get in touch with the Investors Grievance Cell of the relevant Stock exchange.
13. In case you have given specific authorization for maintaining running account, payout of funds or delivery of securities (as the case may be), may not be made to you within one working day from the receipt of payout from the Exchange. Thus, the stock broker shall maintain running account for you subject to the following conditions:
 - a) Such authorization from you shall be dated, signed by you only and contains the clause that you may revoke the same at any time.

- b) The actual settlement of funds and securities shall be done by the stock broker, at least once in a calendar quarter or month, depending on your preference. While settling the account, the stock broker shall send to you a 'statement of accounts' containing an extract from the client ledger for funds and an extract from the register of securities displaying all the receipts/deliveries of funds and securities. The statement shall also explain the retention of funds and securities and the details of the pledged shares, if any.
 - c) On the date of settlement, the stock broker may retain the requisite securities/ funds towards outstanding obligations and may also retain the funds expected to be required to meet derivatives margin obligations for next 5 trading days, calculated in the manner specified by the exchanges. In respect of cash market transactions, the stock broker may retain entire pay-in obligation of funds and securities due from clients as on date of settlement and for next day's business, he may retain funds/securities/margin to the extent of value of transactions executed on the day of such settlement in the cash market.
 - d) You need to bring any dispute arising from the statement of account or settlement so made to the notice of the stock broker in writing preferably within 7 (seven) working days from the date of receipt of funds/securities or statement, as the case may be. In case of dispute, refer the matter in writing to the Investors Grievance Cell of the relevant Stock exchanges without delay.
14. In case you have not opted for maintaining running account and pay-out of funds/ securities is not received on the next working day of the receipt of payout from the exchanges, please refer the matter to the stock broker. In case there is dispute, ensure that you lodge a complaint in writing immediately with the Investors Grievance Cell of the relevant Stock exchange.
 15. Please register your mobile number and email id with the stock broker, to receive trade confirmation alerts/ details of the transactions through SMS or email, by the end of the trading day, from the stock exchanges.

IN CASE OF TERMINATION OF TRADING MEMBERSHIP

16. In case, a stock broker surrenders his membership, is expelled from membership or declared a defaulter; Stock exchanges gives a public notice inviting claims relating to only the "transactions executed on the trading system" of Stock exchange, from the investors. Ensure that you lodge a claim with the relevant Stock exchanges within the stipulated period and with the supporting documents.
17. Familiarize yourself with the protection accorded to the money and/or securities you may deposit with your stock broker, particularly in the event of a default or the stock broker's insolvency or bankruptcy and the extent to which you may recover such money and/ or securities may be governed by the Bye-laws and Regulations of the relevant Stock exchange where the trade was executed and the scheme of the Investors' Protection Fund in force from time to time.

DISPUTES/ COMPLAINTS

18. Please note that the details of the arbitration proceedings, penal action against the brokers and investor complaints against the stock brokers are displayed on the website of the relevant Stock exchange.
19. In case your issue/problem/grievance is not being sorted out by concerned stock broker/ sub-broker then you may take up the matter with the concerned Stock exchange. If you

are not satisfied with the resolution of your complaint then you can escalate the matter to SEBI.

20. Note that all the stock broker/sub-brokers have been mandated by SEBI to designate an e-mail ID of the grievance redressal division/compliance officer exclusively for the purpose of registering complaints.

Self-Assessment Questions

- ❖ Which of the following is not a segment of the NSE?
 - Wholesale Debt Market
 - **Retail Debt Market**
 - Currency derivatives
 - Futures & Options
- ❖ Which of the following does not trade on the exchange?
 - SCM
 - TM
 - CM
 - **PCM**
- ❖ Trading members of the NSE can appoint authorised persons in -
 - F&O
 - CDS
 - **Both the above**
 - None of the above
- ❖ Who issues contract note to a client of a sub-broker for trades on the NSE?
 - Sub-broker
 - **Trading member**
 - NSE
 - NSCCL
- ❖ Which of the following is a back-office activity?
 - Trade capture
 - Trade confirmation
 - **Clearing**
 - Risk management
- ❖ For buy stop loss orders, the trigger price has to be less than or equal to the limit price.
 - **True**
 - False
- ❖ Interim exercise settlement is not a feature of NSE index options
 - **True**
 - False

Chapter 4 **Depository Operations**

A depository is for securities, what a commercial bank is for funds. It opens security accounts on behalf of its clients. When clients buy securities, these are added to the clients' accounts; when clients sell securities, these are reduced from the clients' accounts.

In order to facilitate easy transfer of securities (shares, debentures, government securities, mutual fund units etc.) between buyers and sellers, the securities are not held in physical form, but in an electronic or de-materialised (demat) form. Therefore, the client's securities account is also called a demat account.

Holding securities in demat form leads to the following benefits:

- Easy and quick transfer of securities. Time and cost of sending documents by courier is saved
- On purchase of securities, delivery related risks such as fraudulent certificates and signature not matching, are avoided.
- Stamp duty is exempted on transfer of demat securities.
- Risks of loss related to holding physical securities, such as fire, water and theft are eliminated.
- Nomination facility is available.
- Change in address or bank account needs to be intimated only once, for all the shares held in various companies. With physical securities, individual intimation needs to be sent to each company or its registrar and transfer agent (RTA).
- Transmission of securities on death of the holder again is possible through a single intimation, instead of separate intimation to every investee company.
- Bonus, rights and other entitlements are added to the securities account of clients, without having to follow up with the investee companies.

4.1 *Depository and Issuer*

The company issuing the securities has to enter into contract with the depository and pay the relevant fees and costs. Based on this, the depository will admit the security for dematerialisation.

SEBI has made it mandatory for companies, which are part of leading indices like S&P CNX Nifty, to offer demat facility for their equity investors.

A point to note is that investor can choose to hold the securities in either physical form or demat form. However, the investor will need to have them in demat form for secondary market trading in shares (above 500 shares).

Even if the exchange allows trading in physical form for smaller holding of shares, investors

may be available only for demat shares. 99.9% of trading in the exchanges is through demat. Therefore, it is advisable to hold the securities in demat form, wherever possible.

The investor can opt for conversion of physical form to demat form (de-materialisation) or demat form to physical form (re-materialisation).

4.2 *Depository Participant*

In order to make it convenient for investors to transact their depository operations, the depository appoints bankers, brokers and other financial intermediaries as their agents, with the approval of SEBI. These agents are called Depository Participants (DPs). The DPs are spread all across the country and also abroad.

The investors' transactions like opening the demat account, de-materialisation and re-materialisation are handled through the DPs, while the depository interacts with the issuers and ensures that the entire system operates efficiently.

4.3 *Transactions*

4.3.1 *Account Opening*

In order to open a demat account for any investor, the DP will insist on KYC and other documentation, as discussed in Chapter [1]. An investor can open any number of demat accounts with one or more DPs. However, every DP has its schedule of charges for opening and running the demat account.

The number of demat accounts an investor needs depends on the holding pattern of the investments. An investor holding some securities in own name, and some jointly in the name of spouse, will require two demat accounts – one in own name, and one in joint name with spouse. The spouse will need a separate demat account, if securities are held in the individual name of the spouse.

Unlike a normal bank account, demat accounts cannot be opened on 'either or survivor' basis. Similarly, addition or deletion of names is not possible in the demat account. For any change in names, the investors will have to open a new demat account with the desired names and then transfer securities from the old demat account to the new demat account. Thereafter, the old demat account can be closed.

4.3.2 *De-materialisation*

Investors can transform their security holding from physical to demat form through this process, by submitting Form DRF (Dematerialisation Request Form) along with the physical securities.

The DP sends the request through the electronic system to the issuer/ RTA and the depository. The Dematerialisation Request Number (DRN) that is generated by the system is entered

on the DRF and sent along with the physical documents and a standard covering letter to the RTA.

The physical securities should be defaced by marking them as 'Surrendered for Dematerialisation'. The defacement should be done after confirming that the securities are available for dematerialisation. A list of such securities, with their International Securities Identification Number (ISIN), can be found in the website of the depository.

The ISIN is a unique 12 character number allotted to each security in conformity with the ISIN Standard. The first two characters identify the country. For example, for India it is IN. The next 9 alpha-numeric characters are the basic numbers that identify the company and the specific security of the company. The last digit is the check digit.

On receipt of DRF, the RTA verifies that:

- The DRF has the DP's authorization.
- The dematerialisation request has been received in electronic as well as physical form.
- The DRN in the physical documents matches with the DRN in the electronic request.
- The certificates have the distinguishing marks such as hologram/water mark.

Thereafter, the RTA removes the name of the investor and includes the name of the depository in the register of members.

Confirmation is sent to the DP and the depository. The DP credits the demat units to the account of the investor.

Finally, the share certificates are shredded and details recorded in the Register of Destroyed Certificates.

The process of dematerialisation has to be completed within a period of 15 days from receiving the request.

4.3.3 Re-materialisation

Investors holding securities in demat form can choose to get them converted into physical form. This process is called 're-materialisation'.

Investors will need to submit a Re-materialisation Request Form (RRF) to the DP, who will forward it to the Depository. The entire process adopted for dematerialisation is now reversed.

- The depository validates the information in the RRF and forwards an electronic request through the depository system to RTA.
- The DP sends the RRF to the Issuer/R&T agent who cross verifies it with the electronic confirmation received from the depository. RTA intimates the DP accordingly.

- The R&T agent will capture the information in the RRF and create a new folio or add to an existing folio.
- The names of the beneficial owners will be included in the Register of members of the company and the name of the depository removed.
- RTA will print the share certificates and despatch to the investor. Depository and DP are intimated.
- The DP will debit the demat shares from the demat account of the investor.

Rematerialisation of securities has to be completed within a period of 30 days from the receipt of a request.

4.3.4 Secondary Market Purchases

The clearing house will credit the securities purchased into the account of the investor (or the pool account of the clearing member for further credit to the investor) as per the settlement calendar of the exchange. The credit is made, provided the investor has paid for the securities purchased.

In order to receive the securities, investor will need to provide a 'Receipt In' form to the DP. Accordingly, the DP will accept the securities credited in the account.

Through the Standing Instructions facility discussed later in this Chapter, the investor can avoid having to provide a Receipt In form for every purchase.

4.3.5 Secondary Market Sales

If securities are sold on Wednesday, the settlement will happen in the clearing house on the 2nd working day thereafter i.e. on Friday, in a T+2 rolling settlement calendar.

The clearing member will insist that the investor transfer securities to the clearing member's demat account by Thursday, so that these can be delivered to the clearing house on Friday. In order to provide for contingencies, it would be advisable to transfer the securities to the broker's demat account as soon as the sale transaction is executed in the exchange.

The investor needs to ensure timely delivery of the securities sold. Else there will be a shortage. The investor will have to bear the consequences of the resulting auction.

Power of Attorney (PoA) in favour of the broker ensures that the investor does not need to run against time in transferring the securities for every sale transaction.

4.3.6 Standing Instructions

In the normal course, securities are received into the demat account only if a 'Receipt In' Form is submitted. This would mean that the investor will need to send a 'Receipt In' form every time some securities are purchased. In order to avoid this inconvenience, the investor can tick (✓) 'Standing Instructions' in the account opening form. Based on that, securities will be received without a 'Receipt In' Form.

4.3.7 Power of Attorney (PoA)

As seen earlier, the investor needs to deliver securities to the clearing member within a tight time frame. Delays can be costly. Transactions become convenient, when the broker has a power of attorney for transferring out the securities from the investor's demat account.

PoA has become a standard feature of transacting by investors who are individuals. The investor should however watch the transactions in the account, to be sure that there are no malpractices. The SMS alert facility, discussed later in this Chapter, helps the investor monitor the transactions in the demat account.

4.3.8 Transposition

While the Companies' Act, 1956 permits joint holding of securities, the company's communications are with the holder whose name appears first. Suppose husband and wife hold shares jointly, some with the husband as the first holder, and the others with the wife as the first holder. The company will send separate communications to the husband and wife for the shares in which they are the first holder. Therefore, in the normal course, two demat accounts would have been required – one for each holding pattern.

The joint holders are permitted to write to the company to change the sequence of names. Such change in sequence is called transposition. It does not amount to a transfer.

The joint-holders can sign the Transposition form and submit to the DP. With this approach, the joint holdings can be standardised into a single sequence of names.

The dematerialisation and transposition can happen simultaneously, as a single transaction.

4.3.9 Transmission of Securities

Change in ownership of securities on death of the holder is called 'transmission'. It is simpler, if nomination has been done. The nominee can apply to the DP for inclusion of his / her name on death of the holder or all joint holders, along with certified copy of the death certificate. If the documents are found in order, the ownership of all the securities held in the demat account is transmitted to the nominee.

If nominee is not appointed, then the DP will transfer to legal heir of the deceased holder based on order of the Court. Only in the case of small holdings (value of all securities in the account below Rs. 1lakh) DP may transmit the securities to the applicant on the basis of the following documents:

- Application from the applicant, mentioning the basis on which the application is being made.
- Certified copy of death certificate
- Affidavit / Letter of indemnity from the applicant

- KYC including proof of identity and proof of address of applicant
- DP details of the applicant/s (in the same sequence of names as the securities held, without the deceased holders' name)
- No-objection Certificate (NOC) from other legal heirs
- Such other documents as may be found reasonable by the DP.

The DP will close the demat account of the deceased after all the securities in the account are transmitted to the concerned beneficiary / beneficiaries.

4.3.10 Dividends

Bank account details are part of the account opening form. This enables monetary benefits to be directly transferred to the account of the investor. Thus, the investor's time involved in waiting for cheques, then banking them, and waiting for them to clear are avoided.

Bank account details can be changed subsequently, as discussed in Chapter [1].

4.3.11 Pledging Securities

Both pledger (borrower) and pledgee (lender) will need to have demat account with the same Depository (not necessarily with the same DP).

The pledger provides the details of securities pledged to his / her DP in the standard format. When the pledgee confirms the request through his / her DP, the pledge is recorded.

On repayment of loan, the pledger again submits a request through his / her DP, for the pledge to be released. When the pledgee confirms the request through his / her DP, the pledged securities are released to the pledger.

Bonus shares on the pledged shares are credited to the account of the pledger as pledged shares. So there is no need for a separate pledge for the bonus shares issued.

The pledger will continue receiving dividends on the securities pledged. Only if the pledgee invokes the pledge, and the securities are transferred to the pledgee's demat account, dividends start going to the pledgee.

4.3.12 Freezing of Accounts

Investors can choose to freeze their account (for example, when they do not propose to transact for a long period). Different types of freeze are possible:

- Freeze only debit - During the period that the account is frozen, credits will continue. However, no debits (i.e. transfer out) is possible until the investor unfreezes the account.
- Freeze both debit and credit – No transactions will happen unless the account holder unfreezes the account

- Freeze specific ISIN – A security that the investor does not propose to sell can be frozen through this facility.
- Freeze specific quantity of specific ISIN – Securities beyond the specified quantity are available for transfer out.

The freeze will be reversed when the investor applies for unfreeze physically or electronically.

4.3.13 SMS Alerts

This facility can be availed by giving a written application to the DP mentioning a local (Indian) mobile number. Alerts are provided to investors for the following transactions:

- Change of address
- Change of mobile number
- Credits e.g. allotments in IPO or public issues, bonus shares allotted and new shares issued in lieu of old shares in situations like mergers, split / consolidation of shares
- Debits e.g. securities transferred out as part of delivery for sales executed
- Instructions pending on account of insufficient balance

The facility is mandatory where PoA holders operate the account for individual account holders.

In case of change of mobile number, application can be made to the DP. The change will be confirmed on the old mobile number as well as the new mobile number. Thereafter, alerts will be sent to the new mobile number only.

The alert facility can also be stopped (where there is no PoA) by making a written application.

Self-Assessment Questions

- ❖ What is the form to be used for dematerialisation of securities?
 - DRN
 - **DRF**
 - RRF
 - DF
- ❖ Re-materialisation is to be completed within ____ days of request.
 - 15
 - **30**
 - 7
 - 10
- ❖ Investor can choose to hold the securities in either physical form or demat form.
 - **True**
 - False
- ❖ The maximum demat accounts that an investor can own in his single name is ____
 - 1
 - 2
 - 3
 - **Any number**
- ❖ What are the first 2 digits / characters of ISIN for Indian companies?
 - 91
 - **IN**
 - IS
 - IA
- ❖ _____ reduces the investor's pressures for timely transfer of securities sold.
 - Standing instructions
 - **PoA**
 - Freeze
 - Nomination

Chapter 5 Registrar & Transfer Agent

5.1 Role & Responsibilities

The depository and RTA perform complementary roles in handling the primary and secondary market interfaces between the company and investors.

While the depository handles demat related activities, the entire gamut of investor-related activities in physical securities, as well as corporate actions are handled by the RTA.

The RTA is entitled to become a depository participant.

The RTA's functions are as follows

- Handling investor applications in primary issues. This was discussed in Chapter [2]
- As with public issues, the RTA becomes the principal investor servicing face for rights issues, GDR / ADR issues, sponsored GDR / ADR issues, buyback of securities, consolidation and split of securities, exchange of securities in cases of mergers and acquisitions etc.
- The RTA also handles various corporate actions, such as:
 - o Bonus Issues
 - RTA takes the details of beneficial ownership of demat shares from the depository and determines the bonus entitlement of those investors.
 - RTA issues bonus shares on the demat shares to the depository
 - RTA gives details of allotment of the demat bonus shares for each beneficiary account. Based on this, depository credits demat bonus shares to the demat account of the beneficiary owner.
 - Similarly, RTA determines the bonus entitlement of investors who have not dematerialised their shares.
 - RTA prints bonus share certificates and sends them to investors with non-dematerialised shares.
 - The details of new shareholding are added in the Register of Member.
 - o Rights Issues
 - RTA takes the details of beneficial ownership of demat shares from the depository.
 - RTA determines the rights entitlement of beneficiary owners of demat shares and investors who have not dematerialised their shares.
 - Letter of Offer and Rights Exercise and Renunciation forms are sent to eligible investors.

- RTA processes the rights applications of investors, and reconciles the applications with moneys received in the bank or as ASBA. Accordingly, it processes the allotment of rights shares.
- RTA issues rights shares on the demat shares to the depository, with details of the allotment for each beneficiary owner. Based on this, the depository credits demat rights shares to the demat account of the investors.
- RTA prints rights share certificates and sends them to investors holding physical shares who have been allotted rights shares.
- o RTA processes the dividend payable to investors, as detailed later in this Chapter.
- o RTA handles the transfer of physical securities between buyer and seller.
- o On demise of the owner, RTA also handles the transmission of securities that have not been dematerialised.
- o RTA maintains the Register of Members, based on which the company determines the voting power of investors in meetings.
- o Whenever there is a poll, the RTA helps the company in tabulating the votes and determining the numbers that have supported / rejected / abstained from voting on the resolutions.
- o RTA also handles various requests from investors who have not dematerialised their shares, such as:
 - Change of address
 - Change of bank account details
 - Queries regarding corporate actions not properly received
 - Duplicate share certificates

5.2 Voting Rights in Companies

The Companies Act, 1956 mentions various decisions, which need to be approved by share-holders (also called members) of the company. For example, approval of accounts, appointment of directors, appointment of auditors and approval of dividend.

The directors of the company seek approval from shareholders for various important decisions by proposing resolutions. When share-holders pass the resolution, then the decision stands approved.

Most decisions call for only an 'Ordinary Resolution'. This means that a simple majority is required i.e. the votes cast in favour of the resolution need to be more than the votes cast against (simple majority).

The Companies Act, 1956 mandates a special resolution for some decisions. For example, issuing shares to investors other than existing members. In the case of a special resolution, votes cast in favour of the resolution need to be more than three times the votes cast against it (three-fourths majority). Besides, the intention to pass it as a special resolution should have been communicated in advance to the members, who should have been sent an explanatory memorandum too.

The resolutions are mostly put to vote in a meeting of shareholders. However, companies are permitted to seek the mandate of shareholders through a postal ballot. Further, the central government has a right to insist on a postal ballot for some decisions.

In the case of a postal ballot, shareholders are sent a notice, giving details of the matters on which approval is sought. Shareholders can approve or reject the resolution within 30 days of the date on which the notice is posted. The notice is accompanied by a postage pre-paid envelope for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period.

If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it is deemed to have been duly passed at a general meeting convened in that behalf.

In general, every share is entitled to a single vote. The voting right of a shareholder in a poll is proportionate to his share in the paid up capital of the company. This translates to one vote per share, assuming all shares are fully paid up. Thus, a shareholder who owns 200 shares will have twice the voting power of another shareholder who owns only 100 shares. However, companies are permitted to issue shares with differential rights as to voting, dividend or otherwise. Differential Voting Rights (DVR) is a tool for companies to attract equity capital, while minimizing the dilution of promoters' control over the companies.

In the case of demat shares, the company's records will show the depository as the shareholder. However, voting rights belong to the beneficial owners of those demat shares. The depository will give the company / the RTA the beneficial ownership details for the purpose.

Preference shareholders have the right to vote only on resolutions that affect them as a class. They will get the right to vote on other resolutions of the company if dividend due on the preference shares is unpaid, wholly or partly, in the following scenarios:

- In the case of cumulative preference shares, if dividend default is in respect of an aggregate period of not less than two years preceding the date of commencement of the meeting; and
- In the case of non-cumulative preference shares, if dividend default is either in respect of a period of not less than two years ending with the expiry of the financial year

immediately preceding the commencement of the meeting or in respect of an aggregate period of not less than three years comprised in the six years ending with the expiry of the financial year aforesaid.

5.3 Dividend Payments in Companies

Dividend is paid as a percentage of paid up share capital.

Suppose a company issues shares of Rs. 10 face value at a premium of Rs. 40. The company will receive Rs. 50 against each share. However, if it declares 15% dividend, it will be calculated on the face value. Thus, the dividend would be Rs. $10 \times 15\%$ i.e. Rs. 1.50 per share.

It is possible that some shares are partly paid up. In the above case, if on some shares only 40% of the share capital has been called up (i.e. payment has been sought from shareholders) and paid, then only Rs. 4 per share would be the paid up capital on those shares. The dividend would then be Rs. $4 \times 15\%$ i.e. Rs. 0.60 per share.

Dividend that is paid during a financial year, without waiting for the annual audited results of the company, is called interim dividend. Dividend that is paid after the accounts are audited, is called final dividend. Interim dividend does not require approval of shareholders; final dividend has to be approved by the shareholders.

Although shareholders approve the dividend, it has to be proposed by the directors. If directors do not propose a dividend, then shareholders cannot insist on a dividend. They can only express their dissatisfaction at the general meeting of the company – and thereafter, vote on the resolution, if the directors have proposed a dividend.

When directors propose a dividend (say, on June 15), in the resolution they also mention a record date (say, September 1). This means that shareholders whose names appear in the records of the company as on the record date of September 1 will be entitled to the dividend.

The stock exchange will set a date, say August 16, as the ex-dividend date. This means that all investors who buy shares of the company upto that date will be entitled to the dividend. Thereafter, the shares will be traded Ex-dividend i.e. an investor who buys the shares after that date will not be entitled to the dividend.

With demat shares, the moment the trade is settled, the beneficial ownership of the purchaser is recorded. However, in the case of physical shares, the purchaser needs to ensure that the physical share together with a duly executed transfer deed is sent to the company before the record date. Else, the dividend will be paid to the shareholder whose name is recorded in the Register of Members on the record date.

Although the depository would be mentioned as shareholder for the demat shares, dividends go to the bank account of the beneficial owners of those shares. The depository provides the

requisite beneficial ownership details to the company / RTA for this purpose.

Under the income tax act, dividend distribution tax (DDT) is applicable at 15% plus surcharge (5%) plus education cesses (3%). The total DDT rate amounts to $15\% \times 1.05 \times 1.03$ i.e. 16.2225%. This is to be applied on the dividend paid to the shareholders. The corresponding amount is to be paid by the company to the income tax authorities.

Suppose the dividend paid to the shareholders is Rs. 10lakh. DDT payable by the company to the income tax authorities is Rs. 10lakh \times 16.225% i.e. Rs. 1,62,225.

Although DDT is deducted at source, it is not in the nature of Tax Deducted at Source (TDS). Therefore, shareholders will not receive a TDS certificate based on which any rebate is possible at the time of filing income tax returns.

5.4 Physical Shares

5.4.1 Transfer Deed

In the case of demat shares, the depository maintains details of the beneficial ownership. Ownership passes between buyer and seller based on demat trades executed in the stock exchange.

Where the shares are not dematerialised, the share certificate becomes the proof of ownership. Physical share certificates have to be attached with a transfer deed to enable transfer of ownership from the seller to the buyer.

While delivering shares in the market, the delivering broker is required to affix, on the reverse of the transfer deed a rubber stamp indicating his name, clearing number allotted to him by the Stock Exchange of which he is a member and date of such delivery.

5.4.2 Delays in Transfer of Shares by Companies

In case the transfer deed and the share certificates are with the company awaiting transfer beyond 30 days and in cases where the same are returned by the company to the investor with a company objection including due to signature difference (other than court cases where injunction has been ordered) or if transfer deed is lost in the process of rectification of companies' objection, the companies have to effect the transfer of shares on obtaining from the transferee the proof of purchases duly acknowledged by the stock exchange/broker. If so desired, a company may also obtain indemnity bond from the transferee.

Before effecting transfer, the company has to, within 10 days of the date of such direction, send letters under registered post AD/Speed Post AD to the transferor(s) asking for their confirmations/no-objection, so as reach the company within 15 days from the date of receipt of the letter by the transferor. If the confirmation is received /no-objection is not received within 15 days from the transferor(s), the transfer would be effected immediately thereafter.

The valid objection, if any, should be accompanied by correspondingly old prohibitory order from a competent authority.

Once a share certificate is returned by a transfer agent as a "company Objection" keeping in view the provisions of Section 206 A of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act, 1956, all benefits must be held in abeyance by the company till such time the transfer actually takes place or a valid no objection is received from the Transferee on his receiving replacement.

Immediately after effecting the transfer of shares, the benefits (i.e. Bonus, rights, dividend) held back by the company have to be handed over to the transferee. If such benefits have been passed on to the transferor, the stock exchange has to arbitrate through the brokers of the transferor and the transferee to determine the rightful claimant. Keeping in view the provisions of Section 206 A of the Companies Act and Section 27 of the Securities Contracts (Regulation) Act, 1956, in such cases, the Stock Exchanges are expected to entertain claims for resolving through arbitration even if they are beyond the stipulated time of 4 months.

5.4.3 Good and Bad Delivery Norms

SEBI has laid down the following norms:

- Transfer Deeds

Sl. No.	Description	Good / Bad
1	Transfer Deeds in the prescribed form and printed with the words "For the _____ Stock Exchange." Stock Exchange emblem may or may not be printed. Month and year of printing may or may not be put on the reverse of the Transfer Deed.	GOOD
2	Mutilated Transfer Deed with the signatures of the transferor, witness, Directors and officer of the Company/distinctive numbers/ any material portion badly torn overwritten, or defaced. Typical Cases : A) Material portion defined here only pertains to the material portions at the time of delivery and not prospective one. For a buyer Consideration column, Specimen signature column, Name, Address, Occupation will also be the material portion. Material portion includes transferor's name and signature, company name, folio no., certificate number, distinctive nos., number of shares, name and signature of the transferee, specimen signature of transferee	BAD GOOD GOOD BAD

Sl. No.	Description	Good / Bad
	<p>B) Transfer Deed torn in the prospective material portion</p> <ul style="list-style-type: none"> ▪ Torn and pasted with self-adhesive tape on which the required details can be filled in without any difficulty. ▪ Transfer Deed torn in non-material portion and held together by a transparent tape. ▪ Transfer Deed torn end-to-end in any angle. 	
3	<p>Transfer Deeds with correction in the material portion like, erasure, overwriting, alteration or crossing out by transferor / Authorised Signatory.</p> <p>Transfer Deeds with correction in the material portion like, erasure, overwriting, alteration or crossing out in material portion.</p> <p>Undernoted corrections/ alterations are not considered in material portion.</p> <p>A) Minor spelling mistake in the following fields are valid without the transferor's authorisation provided the word can be properly identified:</p> <ol style="list-style-type: none"> Name of the company. Number of shares in words. names of the Shareholders <p>Illustration Good Bad</p> <p>Telco Teelco Tisco</p> <p>Fifty Feefty feeftteen</p> <p>Ramesh Rameesh Rajesh</p> <p>B) Erasure, overwriting, alteration or crossing out in one or two character in folio numbers.</p> <p>C) Erasure, overwriting, alteration or crossing out in one or two character of "Distinctive Numbers".</p> <p>D) Erasure, overwriting, alteration or crossing out in one or two character of "Certificate Numbers".</p> <p>E) Erasure, overwriting, alteration or crossing out in Number of Shares in figure.</p> <p>F) Erasure, overwriting, alteration or crossing out in one or two character in "Numbers of Shares" in words.</p> <p>G) List of certificate numbers and distinctive numbers attached to transfer deed signed by all transferors.</p>	<p>GOOD if properly authenticated under the full signatures of the transferors</p> <p>Good if properly authenticated under the full signatures of all the transferor(s).</p> <p>Good.</p> <p>Good.</p> <p>Good if certificate number does not contain</p> <p>Any erasure, Over writing, alteration, or Crossing out.</p> <p>Good if distinctive number does not contain</p> <p>Any erasure, alteration or crossing out.</p> <p>Good if Numbers in words does not contain any erasure, overwriting, alteration or crossing out.</p> <p>Good if Numbers of Shares of figures does not contain any erasure, overwriting, alteration or crossing out.</p> <p>Good</p>

Sl. No.	Description	Good / Bad
4	<p>If the name of the transferor (s) in the share certificate & the name in the transfer deed(s) differs materially.</p> <p>Differences of the following type (vice-versa)</p> <p>A) Addition or Deletion of 1 or 2 alphabets</p> <p>B) Krishna Chandra Chelura - C C Krishna</p> <p>C) Corporation - Corpn/Corp.</p> <p>D) Ashok Gupta - Gupta Ashok</p>	<p>BAD</p> <p>GOOD</p> <p>BAD</p> <p>GOOD</p> <p>GOOD</p>
5	<p>Transfer Deeds signed as 'Choonilal' whereas in share certificate the name is spelt as 'Chunilal'.</p> <p>Other than any apparent difference in seller's signature must be accepted.</p> <p>In case of apparent difference like S Rao signing as David.</p> <p>In case S Rao signing as Subhash since the first letter of the signature matches with the initial.</p>	<p>GOOD</p> <p>BAD</p> <p>GOOD</p>
6	<p>Transferor's signature in English, Hindi or any one of the Scheduled languages in India.</p> <p>Assamese, Bengali, Gujarati, Hindi, Kannada, Kashmiri, Malayalam, Marathi, Oriya, Punjabi, Sanskrit, Tamil, Telugu and Urdu - as per Constitution of India - English Schedule (Article 314 (I) and 451).</p>	GOOD
7	<p>Signature of the Transferor is in an Indian language other than the Scheduled languages of India or when the Transferor has affixed his</p> <p>thumb impression. If attested by any person authorised to attest signatures under the Seal/Stamp of his office.</p>	Good
8	<p>Transfer Deeds in respect of joint holdings signed by all the joint holders in any order.</p> <p>Provided the signatures are against the relative names filled up in the Transfer Deed.</p>	GOOD
9	<p>Transfer Deeds without the name of the Company, name(s) of Transferor(s), Folio No., share certificate no., Distinctive no., and number of shares being written.</p>	BAD

Sl. No.	Description	Good / Bad
10	<p>In one lot with one Transfer Deed name on one certificate reading as "Ramesh C Talati" and on another certificate as "Ramesh Chunilal Talati" but Register Folios same on both.</p> <p>In one lot, separate transfer deeds are required for each registered folio.</p> <p>If the transferor's name is identical and folios are different and there is only one transfer deed.</p>	<p>GOOD</p> <p>GOOD</p> <p>GOOD</p>
11	<p>In one lot with one Transfer Deed names on different certificates reading as Ramesh Chunilal Talati and Talati Ramesh Chunilal but</p> <p>Register Folio is same.</p>	GOOD
12	Income Tax Authority or Collector signs as Transferor. (Number and Date of the relative Order necessary).	GOOD
13	Instead of Executor's signature, his Agent's signature is put on the Transfer Deed. (Number and Date of Registration of Power of Attorney necessary).	GOOD
14	Executor's signature without his rubber stamp. (Number and Date of Registration of Power of Attorney necessary).	GOOD
15	<p>In the case of Units transfer deed in the name of a Minor and signed by natural Guardian. (In the case of Court Guardian, a court order is required).</p> <p>Shares cannot be held in the name of a Minor unless accompanied by Court Order granting permission for sales/purchase which is beneficial to the Minor.</p>	<p>GOOD</p> <p>GOOD – if accompanied by the relevant Court Order for sale.</p>
16	<p>Transfer Deeds signed by an individual against whom insolvency proceedings are pending.</p> <ul style="list-style-type: none"> Unless the transfer deed is duly certified and countersigned by the Official Assignee. 	<p>BAD</p> <p>GOOD</p>

Sl. No.	Description	Good / Bad
17	<p>Transfer deeds signed under Power of Attorney where the power given is subject to conditions.</p> <ul style="list-style-type: none"> Transfer deed signed by Director of the Company and Under board Resolution not mentioned on the front or the reverse of the transfer deed. <p>Transfer deed signed by an authorised signatory under Power of Attorney.</p> <ul style="list-style-type: none"> Transfer deed signed by an authorised signatory of a custodian and the PoA registration no is mentioned on face or the reverse of the transfer deed. Where the transfer deeds are signed by an authorised signatory under a Board Resolution and the stamp UNDER BOARDRESOLUTION is mentioned on the face or the reverse of the transfer deed. <p>Transfer deeds signed under Power of Attorney where the power given is subject to conditions.</p> <ul style="list-style-type: none"> Transfer deed signed by Director of the Company and under board Resolution not mentioned on the front or the reverse of the transfer deed. <p>(Stamp of introducing member is not required to be affixed on the reverse of the transfer deed)</p> <ul style="list-style-type: none"> Transfer deed signed by an authorised signatory under Power of Attorney. Transfer deed signed by an authorised signatory of a custodian and the PoA registration no. is mentioned on face or the reverse of the transfer deed. <p>(Stamp of introducing member is not required to be affixed on the reverse of the transfer deed)</p> <ul style="list-style-type: none"> Where the transfer deeds are signed by an authorised signatory under a Board Resolution and the stamp UNDER BOARDRESOLUTION is mentioned on the face or the reverse of the transfer deed. <p>(Stamp of introducing member is not required to be affixed on the reverse of the transfer deed)</p>	<p>BAD GOOD GOOD only if PoAregn no, date signature and stamp of the introducing Member is mentioned on the reverse of the Transfer Deed. GOOD GOOD BAD GOOD GOOD only if PoAregn no, date signature and stamp of the introducing Member is mentioned on the reverse of the Transfer Deed. GOOD GOOD</p>

Sl. No.	Description	Good / Bad
18	<p>Transfer Deed signed by a custodian on behalf of a client</p> <ul style="list-style-type: none"> In the signature column the custodian does not put the stamp as 'Constituted Attorney' on behalf of the transferor. Transfer Deed signed by a Custodian on behalf of the client and in the signature column it puts the stamp "By Constituted Attorney to the transferor" with the P/A number given on the reverse of the TD with the stamp and signature of the custodian. <p>The above mentioned details entered on the face of the TD and not mentioned on the reverse of the TD</p> <p>Transfer Deed signed by a custodian on behalf of a client</p> <ul style="list-style-type: none"> In the signature column the custodian does not put the stamp as 'Constituted Attorney' on behalf of the transferor. Transfer Deed signed by a Custodian on behalf of the client and in the signature column it puts the stamp "By Constituted Attorney to the transferor" with the P/A number given on the reverse of the TD with the stamp and signature of the custodian. <p>The above mentioned details entered on the face of the TD and not mentioned on the reverse of the TD</p>	<p>BAD GOOD GOOD BAD GOOD GOOD</p>
19	<p>Shares sold by FIIs and transfer deed signed by a Custodian on behalf of the FII.</p> <p>(Copy of RBI approval is not required to be attached with each market lot).</p>	GOOD
20	<p>In case of GDR,</p> <ul style="list-style-type: none"> photocopies of the RBI approval attached to the deliveries ; OR if RBI approval number and date is mentioned on the transfer deed and attested by the introducing member. 	<p>GOOD GOOD</p>
21	<p>Consideration amount and date of execution of the transfer deeds are filled in pencil</p>	BAD
22	<p>Transfer Deeds signed by or on behalf of a Company against which liquidation proceedings are pending.</p> <ul style="list-style-type: none"> Unless the Transfer Deed is certified and countersigned by the Liquidators. 	<p>BAD GOOD</p>

Sl. No.	Description	Good / Bad
23	<p>The name of the delivering broker with his SEBI Registration number and date not mentioned at the back of the Transfer Deed.</p> <p>In case the shares are delivered to the Clearing House by the Custodian and the Transfer deed bears the stamp of Custodian along with the Clearing Number of the Broker on whose behalf the shares are delivered.</p> <p>The date should be the pay-in date/ delivery date only.</p>	BAD GOOD
24	<p>Shares held by a TRUST and Signed on the Transfer Deed as 'NAMEOF TRUST - PROPRIETOR'.</p> <p>TD signed as "NAME OF TRUST - TRUSTEE'.</p> <p>Shares held in the name of a trust, if accompanied by a copy of the resolution or the relevant portion of the trust deed authorising the trustees to transact in securities on behalf of the trust.</p>	BAD BAD GOOD
25	If shares held are duly registered by the company in the name of the HUF (Shares held by HUF and signed by KARTA).	GOOD
26	<p>Transferor's signature witnessed by a person but his full name not given.</p> <p>(as long as the name and address of the witness are perfectly legible).</p>	GOOD
27	<p>Witness's name, address and signature is in a language other than English but in language specified by the Ministry of Finance.</p> <p>Assamese, Bengali, Gujarati, Hindi, Kannada, Kashmiri, Malayalam, Marathi, Oriya, Punjabi, Sanskrit, Tamil, Telugu and Urdu - as per Constitution of India - English Schedule (Article 314(I) and 451).</p> <p>If signed in a language other than specified by the Ministry of Finance.</p>	GOOD BAD
28	<p>Attestation stamp in any one of the Scheduled languages in India, Indian languages :</p> <p>Assamese, Bengali, Gujarati, Hindi, Kannada, Kashmiri, Malayalam, Marathi, Oriya, Punjabi, Sanskrit, Tamil, Telugu and Urdu - as per Constitution of India - English Schedule (Article 314(I) and 451).</p>	GOOD

Sl. No.	Description	Good / Bad
29	<p>Transferor's signature attested by a Bank official</p> <ul style="list-style-type: none"> Only the designation mentioned. If the name, Designation of the attesting authority signing along with the complete address is given 	<p>BAD GOOD</p>
30	Attestation by Gram Panchayat or a Surpanch or Village Magistrate or Village Munsiff under his seal.	GOOD
31	Signature attested by any person authorised to attest signatures with his full name and address with the Official Seal/Stamp of his office.	GOOD
32	<p>Transferor's signature is attested by a Notary Public.</p> <p>(The necessary seal, rubber stamp, adhesive stamps as prescribed for such attestation should be affixed in cases where Notary attestation is required i.e. In cases where Rectification of objections is required due to signature differences).</p>	GOOD
33	<p>Transfer Deed is signed by the transferor</p> <ul style="list-style-type: none"> Signature is clearly of a name different than the name of the transferor. If signature is same for two different shareholders under two different Transfer Deeds. 	<p>BAD BAD</p>
34	<p>Marketable lot with more than five transfer deeds.</p> <p>Upto five transfer deeds used to make a marketable lot.</p>	<p>BAD GOOD</p>
35	<p>New shares which are issued on pro rata basis and old shares standing in the folio and name of same transferor and accompanied by one transfer deed for a marketable lot. (The new share dividend declared for the previous year i.e. the old new compensatory value (ONCV) would be payable on the entire market lot).</p>	GOOD
36	Company's name has been changed but it has not been corrected on the share certificate.	GOOD

Sl. No.	Description	Good / Bad
37	Abbreviated name of a Company filled up in the transfer deed. If from the abbreviated name the identity of the company can be ascertained. The name of the Company should be identifiable., e.g. TELCO, TISCO, L&T, etc.	GOOD
38	Exact position of TDs to be attached on top of the certificate. TD should be placed on the top of the share certificate.	
39	Transferor and witness is the same.	BAD
40	Transfer Deed in the prescribed form and name of a particular Stock Exchange filled in or not.	GOOD
41	Transfer Deed not in the prescribed form	BAD
42	Witness and attesting authority identical	GOOD
43	Transfer Deeds bearing signatures of witnesses, the address of the witness being in a different city or town or Centre other than that of Transferor or Transferee.	GOOD
44	Prescribed Authority (ROC) seal overlapping and stamped twice. Even if the signature of the Registrar of Companies is partly printed and the date stamp is also partly printed but both the signature and the date should be apparent.	GOOD
45	The Endorsement of the Prescribed Authority (e.g. Registrar of Companies) bears the same date as the date from which the Register of Members of the Company is closed.	GOOD
46	If the Endorsement of the Prescribed Authority (e.g. Registrar of Companies) bears a date prior to the date of issue of share certificate or the date of allotment of shares. Provided the Endorsement of the Prescribed Authority bears a date of or after the date from which the Register of Members of the Company closed last.	Good
47	Transfer Deed endorsed by the Prescribed Authority on a date prior to closure of the Register of Members of the Company delivered after the date of closure of Register of Members.	Bad

Sl. No.	Description	Good / Bad
48	Transfer Deeds accompanying debenture certificates or any other permissible listed security (other than equity) whether date-stamped by the Prescribed Authority or not. Provided for the convertible portion a separate date-stamped Transfer Deed is delivered.	Good
49	Transferor's signature on the transfer deed with the date on which he has signed	GOOD
50	Witness is a Non-Resident and the address given is of a foreign country	GOOD
51	Distinctive numbers range "To" partly filled in the transfer deed. e.g.4589201 - 300 etc.	GOOD
52	In the case of mutual funds, the ROC stamp and signature are missing(except in case of Schemes of Unit Trust of India).	GOOD
53	Certificates with multiple folios per market lot attached to separate transfer deed (subject to guideline no.35 above).	GOOD
54	Logo of the Stock Exchange on the reverse of the transfer deed missing.	GOOD
55	Attestation of the transferor's signature is not mandatory. except in the case where the transfer has been returned by the company due to SIGNATURE DIFFERENCE.	GOOD
56	Units issued with the terms 'either or survivor', if signed by all holders If signed by any one of the holders	GOOD GOOD
57	Transferor's signature on the transfer deed is facsimile signature for Registered Custodians.	GOOD
58	Certified Transfer Deed Provided the name and address of the Transferor the distinctive numbers of the shares covered by the Transfer Deed and date of certification are given.	Good
59	Any erasure or alteration in the Certified Transfer Deed. When authenticated by an authorised signatory of the Company.	Good
60	Certified Transfer Deeds and share certificates delivered in part for bargains in market trading unit.	Good

Sl. No.	Description	Good / Bad
61	In case of shares under lock in-period, if the transfer deed date is prior to the lock-in period last date but the date of introduction into the market is after the last date of lock-in period. If the transfer deed date is prior to the lock-in period last date and the date of introduction into the market is before the last date of lock-in period.	GOOD BAD
62	Some companies allot record numbers for shares issued by them apart from distinctive number ranges. For these shares, if record number is filled up along with distinctive number ranges on the transfer deed. If only the record number has been filled up instead of distinctive number ranges on the transfer deed.	GOOD BAD
62A	Transfer deeds (dated July 1, 1997 and thereafter) bearing rubberstamps on the reverse thereof other than those of members of the stock exchanges/clearing house/clearing corporations, SEBI registered sub-brokers and Remisiers registered with the stock exchanges.	BAD

• Share Certificates

Sl. No.	Description	Good / Bad
63	Name of the company or emblem is not readable in the common seal or there is no common seal on the share certificate	Good
64	The last date for payment of call has expired and the call has not been paid or if the call has been paid, the necessary Call Report has not been attached. The call payment receipt with the stamp of the Bank before or on the due date if attached to the securities is good delivery for three months from the last date of call payment or next book closure announced by the company whichever is later. All call payment receipts after due date must be endorsed as "cheque/draft realised" by the Bank/co./Registrars.	BAD GOOD GOOD
65	All securities with stickers issued by the companies in lieu of endorsement.	GOOD
66	If call money paid but not endorsed on share certificate even after the book closure but transfers affected after the call payment date.	BAD
67	If the final call is endorsed but the initial or the initial and the second call not endorsed. (i.e. if marked "FULLY PAID").	GOOD
68	In case of fully convertible debentures, after the debentures have been converted into equity, if the call money endorsement has been done only for the equity portion and not for the debenture portion.	GOOD

Sl. No.	Description	Good / Bad
69	Call paid endorsements made by the Company with the call amount, date of payment and signature of the Authorised Signatory with or without the Rubber Stamp of the Company.	GOOD
70	In the case of partly paid shares, when a call has been made but not paid and delivery effected during the period of ten days before the last date fixed for payment. If the call receipts are attached to the documents.	BAD GOOD
71	Application Receipts and Call money receipts not bearing bank stamp and payment details.	BAD
72	Any significant correction, erasure, overwriting, crossing out or alteration in the quantity of shares, in the last registered holders name or in any material particulars on the share certificate. Unless the Authorised Signatory who has signed on the certificate, authenticates the correction Or the correction is initialled and authenticated by any other officer under the Company's rubber stamp.	BAD GOOD
73	Certificates badly torn as is not to be in deliverable condition or share certificate torn through and through or badly torn as to obliterate or render illegible or create the impression of cancelling the numbers or directors or other signature or the date or any other particulars or if it is written upon or damaged or mutilated by advertisements, printing, rubber stamp or otherwise or if a material part of the certificate be torn out or cut off.	BAD
74	Share certificates defaced or mutilated in portion: The following will be considered as material portion in the case of share certificate: (i) Share certificate torn end to end and pasted with transparent self-adhesive tape. (ii) Where shares have been transferred to a new holder and if torn at the original holders name portion. (iii) Folio number and name overwritten in one or two characters and not authenticated by the authorised signatory. (iv) If the share certificate is torn at the company name portion but is decipherable. (v) Corrections in transfer Number or Date of transfers, if legible and not authenticated. (vi) Share Certificates with bar codes not concealing any material information.	BAD BAD GOOD GOOD GOOD GOOD GOOD
75	If the name of the Company has been disfigured in the body of the share certificate so as to affect it materially. If the name of the company is identifiable.	BAD GOOD
76	Certificates in the case of UNITS discharged by the transferor for purpose of repurchase and then cancelled by him and initialled.	BAD
77	Share certificate contains one name but the transfer deed consists of two signatures. If both the signatures on the transfer deed are identical in nature or can be identified as signature of the same person. If the transferor has signed twice but has struck off the 2nd signature.	BAD GOOD
78	Share certificate contains name of one transferor but transfer deed contains two names and signature respectively.	BAD

Sl. No.	Description	Good / Bad
79	Preferential / promoters quota shares under lock-in period delivered which are not transferable.	BAD
80	Share certificate issued without the signature of Secretary / Authorised signatory. If the shares are transferred subsequently and the authorised signatory has signed against such transfer.	BAD GOOD
81	Signature missing in the initial column but signed by Authorised signatory in the required column on the reverse of the certificate.	GOOD
82	Endorsement effected on the reverse of the certificate and struck off and again endorsed. subject to proper authentication by the Company by putting a round stamp of the Company.	GOOD
83	Certificate with company's old registered office crossed out and new address stamped without authentication.	GOOD
84	Certificate without mentioning the place of issue.	GOOD
85	Revenue stamp affixed on the certificate concealing any material portion of the certificate. Provided any material portion like lock-in period date, NRI details are not affected.	GOOD
86	Revenue stamps affixed / impressed by the Company on the share certificate has come off.	GOOD
87	Any alteration or erasure or correction without initials in the transfer endorsement on the back of the share certificate as for example made in the year 1960 and subsequently the shares have again been transfer red by the Company, say in 1961.	GOOD
88	Share certificates with irrelevant or extraneous rubber stamp or writings on the scrip. Provided the rubber stamp or the writings does not affect any material portion of the scrip.	GOOD
89	Increase or decrease of the Capital and if the certificate does not carry the endorsement on the face of the certificate.	GOOD
90	Absence of holder's discharge on the Letter of Allotment.	GOOD
91	Share Certificate and Transfer Deed not attached together.	BAD
92	Shares standing in the name of Non-Resident Individuals. Provided the declaration stamp as per the RBI guideline is affixed and counter signed by the introducing member.	GOOD
93	Name of the holder printed in two lines which looks like joint holding or one line of address printed and looking like second holder.	GOOD
94	Lock in period mentioned in the certificate, without specific date of release of lock in.	BAD
95	Shares issued in the name of Sole Proprietor / Partnership firm signed by the Proprietor / Partner. Units / debentures issued in the name of Sole Proprietor / partnership firm signed by the Proprietor / partner.	BAD
96	In case the shares of a company are not paripassu with the existing equity shares of the company in two financial years then new share dividend declared for the previous year i.e. the old new compensatory value (ONCV) for two years has to be paid. The full dividend declared will have to be paid (interim + final).	GOOD

▪ Miscellaneous

Sl. No.	Description
97	Validity period of Company Objection by the last buying broker to be notified to the Exchange/ Introducing Broker is 12 months from the date of the objection memo. In all other pending cases of company objections bearing a date prior to July 16, 1996, the validity period will be as per rules – of the respective exchanges – as existing prior to July 16, 1996.
98	Objections must be accompanied with Share Certificates.
99	Shares lodged for transfer after book closure (but before one year from the date of date stamping the transfer deed) are returned under objection can be lodged as company objection.
100	<p>Where the shares have been duly transferred by the company in the name of the transferee, and thereafter the company sends a letter informing transferee that the shares have been transferred based on fraudulent documents, such cases can be lodged as company objection subject to the following conditions and procedure :</p> <ul style="list-style-type: none"> ▪ In cases where the company has transferred certificates which are fake and later sends a letter informing that the shares have been transferred on fraudulent certificates, such cases will NOT be treated as company objections and the company will be responsible for the transfer. ▪ In cases where the shares are under stop transfer, stay order, non-transferable(lock-in period) or shares are partly paid and the company has transferred the shares and later sends a letter informing that the shares have been transfer red on fraudulent documents, such cases will NOT be treated as company objections and the company will be responsible for the transfer. ▪ In cases where the certificates are genuine but the transfer deed is forged (i.e. the company has transferred the shares in good faith) the shares can be accepted as company objection. In such cases the company should necessarily enclose the copies of both sides of the transfer deeds based on which shares were transferred by the company in favor of the holder and which later on has been found to be based on forged documents, and all subsequent transfers thereafter along with the objection. <p>Procedure : (In order to simplify the understanding of the procedure, the following illustration has been used: A ---> B ---> C ---> D ---> X ---> Y ---> Z The shares were first sold through 'A' in the market. After passing through 'B' and 'C' the shares were lodged by 'D' to the company for transfer. After receiving the shares duly transferred from the company in his name 'D' sold the shares in the market. These shares after passing through 'X' and 'Y' are finally sent by 'Z' to the company for transfer in his/her name. After receiving the shares from the company duly transferred in his name, 'Z' has received a letter from the company stating that the shares transferred in the name of 'D' were based on fraudulent documents.</p> <ul style="list-style-type: none"> ▪ 'Z' will report the objection along with the company objection against 'D'. ▪ 'D' will rectify/replace the shares within 21 days as per the BDC procedures. ▪ 'D' may in turn lodge the bad delivery for rectification through the BDC against 'A'. <p>The validity period of reporting such cases will be 36 months from the date of latest transfer by the company (in the above example 36 months from the date the shares were transferred in the name of 'Z'). The company will also furnish copies of both sides of transfer deed based on which shares were transferred in favor of 'Z' and 'D' along with the objection memo.</p>

Sl. No.	Description
101	<p>In case of joint holding, and in event of death of any of the holders, transfer can take place on the basis of death certificate accompanying the transfer deed only for a period of two years from the date of the death or ensuing book closure, whichever is later.</p> <p>The Introducing member of a recognised stock exchange may certify/attest copy of the death certificate and also issue an identity certificate in case where the name of the deceased on the share certificate is not identical with the name on the death certificate – GOOD</p>
102	While rectifying objections due to signature differences, a fresh signature by the transferor (if the same transfer deed is re-submitted) along with attestation is mandatory. Fresh transfer deed is mandatory if objection is rectified after book closure date.
103	In case Rights/Bonus shares tendered as corporate benefits are reported as bad delivery, if it is odd lot, the value of shares based on the rate prevalent on the day of reporting bad delivery will be paid.
104	Rectification/replacement of transfer deed under objection should be in market lot only (even if transfer deed under objection is submitted in non-market lot).
105	If Jumbo transfer deed is submitted as company objection, original transfer deeds need not be returned by the receiving member.
106	When documents are returned under signature difference, the transfer deed can be tested by the introducing member. If the introducing member is a corporate, the Director or authorised signatory can attest the transfer deed, under his company's stamp, with SEBI Registration Number.
107	For reporting as company objections, the transferee portion of the transfer deed should be duly filled in.
108	<p>For reporting as company objection, the following documents are required:</p> <p>A. If they are returned as objection from the company due to the above reason:</p> <ul style="list-style-type: none"> ▪ company objection memo stating that the shares are fake/ forged ▪ copies of both sides of the transfer deeds ▪ copies of both sides of the share certificates <p>B Otherwise one of the following documents are required:</p> <ul style="list-style-type: none"> ▪ public notice given by the company/registrar ▪ notification from any stock exchange ▪ letter of intimation from the company to stock exchange.
109	<p>For reporting missing/lost/stolen shares as objection the following documents are required :</p> <p>A. If they are returned as objection from the company due to above reason:</p> <ul style="list-style-type: none"> ▪ company objection memo stating that the shares are missing/lost/ stolen accompanied by a copy of Court Order or FIR or copy of acknowledged police complaint ▪ copies of both sides of the transfer deeds ▪ copies of both sides of the share certificates <p>B. Otherwise one of the following documents are required :</p> <ul style="list-style-type: none"> ▪ public notice given by the company /registrar ▪ notification from any stock exchange ▪ letter of intimation from the company to stock exchange <p>In cases where duplicate shares have been issued to a third party under the provisions of section 108 (1) A of the Companies Act, the company should also provide the name and address of the third party to whom the duplicate share have been issued along with the date of request for duplicate shares by the third party.</p>

Sl. No.	Description
110	Attestation is required where signature of transferor is in an Indian language other than the Scheduled languages in India or when the transferor has affixed his thumb impression (guideline no. 7) In other cases, attestation is compulsory only when shares come under objection due to signature difference. Hence, guideline Nos. 28, 29, 30, 31 & 32 apply only to transfer deeds which come under objection due to signature difference.

There is a conflicting interpretation of clause 97 and clause 100. In such cases the provisions of clause 97 will prevail.

Self-Assessment Questions

- ❖ Rights entitlements of shareholders is calculated by
 - Depository
 - Depository Participant
 - **RTA**
 - Custodian
- ❖ The RTA is entitled to become a DP.
 - **True**
 - False
- ❖ In a postal ballot, shareholders get _____ days to decide on resolutions.
 - 7
 - 10
 - 15
 - **30**
- ❖ In a poll by a company, who gets to vote?
 - Depository
 - DP
 - **Beneficiary Owner**
 - RTA
- ❖ Dividend is paid as a percentage of:
 - Subscribed Capital
 - Called up Capital
 - **Paid up Capital**
 - Authorised Capital
- ❖ If directors do not propose a dividend, then shareholders cannot insist on a dividend.
 - **True**
 - False
- ❖ Which of the following is true of DDT in the case of shares of a company?
 - Rate depends on whether the investor is Individual / HUF or belongs to some other category of investors
 - **Is applicable at 15% plus surcharge (5%) plus education cesses (3%)**
 - Is applicable at 25% plus surcharge (5%) plus education cesses (3%)
 - Investors have to be issued TDS certificates within 1 month

Chapter 6 Mutual Fund: AMC Operations

6.1 *Legal Structure*

Various entities are associated with the mutual fund structure. It is important to understand these entities and their roles, to appreciate the role of back office in handling of mutual fund investors' transactions.

The prime mover behind setting up a mutual fund is the *sponsor*.

Under the regulations, Mutual Funds are to be constituted as *trusts*. The term 'XYZ Mutual Fund' is a reference to such a trust. The sponsor establishes the trust through a *trust deed*. The beneficiaries of the trust are the investors in the various schemes floated by the fund. The trust acts through *trustees*, who are appointed by the sponsor. Prior permission of SEBI is to be taken, before a person is appointed as trustee. The trustees as a group are referred to as *Board of Trustees*.

Instead of appointing individuals as trustees, the sponsor can also appoint a *trustee company* i.e. a company that performs the role of trusteeship. The company will operate through directors; together they are referred to as *Board of Directors*.

The trustees (or directors of the trustee company) have a key role in protecting the interests of investors.

Day to day operations of the mutual fund are handled by an Asset Management Company (AMC), appointed by the sponsor or the trustees. Role and responsibilities of the AMC are laid down in the investment management agreement executed with it.

The AMC, like any company, has directors. Prior approval of the trustees is required, before a person is appointed as director on the board of the AMC.

The AMC floats mutual fund schemes on behalf of the mutual fund trust. Investors invest in these schemes. Investor's investment in mutual fund schemes is represented by 'units' (like shares in the case of investment in companies).

When a scheme sells units to an investor, it is called 'Sale' transaction. When the scheme buys those units back from the investor, it is called 'Re-purchase' transaction.

In the mutual fund legal structure, it is the AMC which owns or leases offices, and employs fund managers and other employees to perform its role as investment manager. The AMC needs to work under the overall supervision and guidance of the trustees, who have the responsibility of protecting investors' interests.

As another check in the system, the regulations require that the mutual fund appoint a custodian, who will have custody of the various investments made by the fund. Thus, the investment management responsibility is handled by the AMC, but the custodian has custody

of those investments. The custodian operates in line with a custodial agreement, which is executed with the trustees.

Offices of the AMC handle the servicing of investors in its various mutual fund schemes. The AMC can also choose to appoint a Registrar and Transfer Agent (RTA). Most AMCs choose to appoint a RTA.

The AMC can also appoint different RTAs for different schemes. Some AMCs do.

The AMC, or, if appointed, the RTA, is responsible for maintaining investor records. The RTAs (who may cater to multiple AMCs) have a wide geographic presence through their investor servicing centres (ISCs). These perform a useful role in catering to the needs of investors, physically in the ISC offices, as well as through internet and mobile channels.

As is evident from the discussions so far, the AMC is a legal entity, different from the scheme. Therefore, the AMC's accounts are different from the Scheme's accounts. An AMC can also choose to appoint a *Fund Accountant* to maintain the accounts of the various schemes managed by it.

The regulations require that the AMC's auditors are different from the scheme's auditors.

The schemes are sold in the market by mutual fund *distributors*. Some of them (banks and large distribution houses) have pan-India reach, while some others have a regional reach. Several individuals too, operating as Independent Financial Advisers (IFAs) perform the role of selling mutual funds.

Stock Exchange brokers are being encouraged to sell mutual funds as an additional investment option for their clients. NSE Offers NEAT MFSS platform to help its stock exchange brokers offer mutual fund services to their clients.

Back office activities are spread across all these entities. The activities related to mutual fund operations by NSE trading members are discussed in the next chapter. Other operations are discussed in the rest of this chapter.

6.2 Net Asset Value (NAV)

The size of a scheme is measured by its net assets, which depends on:

- The amount mobilized in the NFO (initial corpus)
- Valuations in the market (better the valuation, higher the net assets)
- Sales and Re-purchases of units, in the case of open-ended scheme (Sales of new units will increase net assets; re-purchase of existing units will reduce net assets).
- Income and expenditure (income would increase the net assets; expenses would decrease the net assets).

Every scheme has a value of net assets, which represent the worth of the units that have been issued to investors.

The net assets divided by the number of units is the scheme's NAV, an important metric that is used for evaluating performance of schemes.

Suppose a scheme collected Rs. 100 crore from investors. In its first year of operations, it has incurred expenses of Rs. 1 crore, of which Rs. 0.20 crores is payable. It has earned Rs. 1.5 crore as interest and dividends. The market value of its investments is Rs. 110crore, as against their cost of Rs. 95 crore. It has booked a capital gain of Rs. 0.30 crore on some investmen ts it has sold. The scheme has Rs. 6 crore in the bank.

The company's profits (in Rs. crore) can be calculated as follows:

Income from Interest & Dividend	Rs. 1.50	
Realised Capital Gains	<u>Rs. 0.30</u>	Rs. 1.80
Expenses		<u>Rs. 1.00</u>
Realised Profit		Rs. 0.80
Unrealised Capital Gains:		
Market Value of Investments	Rs. 110.00	
Cost of Investments	<u>Rs. 95.00</u>	<u>Rs. 15.00</u>
Total Surplus Carried to Reserve		Rs. 15.80

The scheme's assets and liabilities (in Rs. crore) are as follows:

Liabilities

Unit Capital	Rs. 100.00	
Reserves	<u>Rs. 15.80</u>	
Net Worth		Rs. 115.80
Expenses Payable		<u>Rs. 0.20</u>
Total Liabilities		Rs. 116.00
Investments		Rs. 110.00
Bank		<u>Rs. 6.00</u>
Total Assets		Rs. 116.00

The NAV of the scheme is its net worth divided by the number of units. Assuming Rs. 10 as the face value of each unit, the scheme would have issued 10crore units to receive unit capital of Rs. 100 crore.

The net assets that belong to the investors are represented by the net worth of Rs. 115.80 crore.

NAV of each unit of the scheme is Rs. 115.80 crore ÷ 10crore i.e. Rs. 11.58.

Thus, the intrinsic value of the units of a scheme(including unrealised gains on investments) is its NAV. The NAV keeps changing. The schemes declare their NAV every day.

'Net assets' is also called *assets under management (AUM)*. The total AUM of all schemes managed by an AMC, is the AUM of that AMC.

6.3 Expenses

The profits or losses in a mutual fund scheme belong to investors who have invested in that scheme. Expenses pull down the NAV of a scheme. Therefore, SEBI has mandated various regulations to control the expenses that are charged to a scheme.

The AMC's role goes beyond fund management to various day to day operations like sales, accounting etc. In order to perform its role, the AMC establishes offices, recruits employees, ensures the requisite data and systems support etc. The related rent, salary, software and other establishment expenses, incidental to the AMC performing its role, are to be borne by the AMC itself. The scheme pays an asset management fee to the AMC, out of which the AMC has to meet these establishment expenses.

Thus, the asset management fee is an expense for the scheme (but not the rent, salary etc.). Similarly, the scheme incurs several other expenses such as:

- Expenses for services provided by custodian, RTA, auditors and bankers
- Fees to depository for demat arrangements, and stock exchanges for listing
- Advertising and sales promotion expenses
- Commissions for distributors
- Printing offer documents, application forms etc.
- Expenses for investor services, such as fund account statements, dividend warrants, redemption cheques etc.
- Service Tax

SEBI has prescribed limits to such scheme expenses, which are of a recurring nature, as follows:

Net Assets (Rs crore)	Equity Schemes	Debt Schemes
UptoRs 100 crore	2.50%	2.25%
Next Rs 300 crore	2.25%	2.00%
Next Rs 300 crore	2.00%	1.75%
Excess over Rs 700 crore	1.75%	1.50%

Thus, an equity scheme with net assets of Rs150crore, can incur recurring expenses, as follows:

First Rs100crore of net assets	2.50% i.e. Rs2.500crore
Rs150crore less Rs100 crore i.e. Rs50crore	2.25% i.e. Rs1.125crore
Total	Rs3.625crore

The above limits are subject to the following further restrictions:

- The management fee component (paid to the AMC) cannot exceed 1.25% on the first Rs100crore of net assets of each scheme; on the remaining net assets, the management fee cannot exceed 1%.
- Debt schemes cannot charge a management fee on the funds that are parked in short term deposits with commercial banks.
- The following expenses cannot be charged to the scheme:
 - o Initial issue expenses
 - o Establishment expenses, infrastructure costs, depreciation, fund accounting expenses, software expenses, general administration and investment management expenses (all of which are to be borne by the AMC out of the management fee it earns)
 - o Corporate advertising
 - o Legal, marketing, printing and other expenses that do not relate to any schemes.
 - o Interest on delayed payments to unit-holders
 - o Fines and penalties for violating any laws.

Given the nature of the schemes, lower expense limits are available in the following cases:

- Recurring expense limit is 1.5% for index funds and Exchange Traded Funds. Within this, the management fee cannot exceed 0.75%
- Recurring expense limit is 0.75% for fund of funds.

6.4 Load

An investor would expect that his transactions with the scheme would happen at the NAV of its units. Thus, if the NAV is 12, he would expect to receive 1000 units, if he invests Rs12,000. Similarly, if he offers 500 units for re-purchase, he would expect to receive Rs12 X 500 i.e. Rs6,000.

In the above case, if the scheme were to charge Rs12.10 for selling a new unit to the investor, then he would receive fewer than 1,000 units for his investment of Rs12,000. The Rs0.10 paise would thus become a load borne by the investor. It is called *entry load*.

Entry Load is not permitted by SEBI. Therefore, the price at which units are sold to the investor viz. *Sale Price*, is equal to the NAV of the scheme.

Similarly, if the scheme were to pay the investor only Rs11.88 per unit when he offers 500 units for re-purchase, he would receive less than Rs6,000. The Rs0.12 paise (which work out to 1% of NAV) would thus become a load borne by the investor. It is called *exit load*. This is permitted.

The scheme might also have a structure, where the investor would have to bear a graded load, depending on the period of his unit-holding. For instance, the load would be 1% if the investor holds the units for 4 years; 2% if the investor holds the units for 3 to 4 years; 3% if the investor holds the units for 2 to 3 years; and so on and so forth. Thus, an investor continuing in a scheme longer would bear a lower load than an investor who holds his investment for a shorter period. Such graded structures are called *contingent deferred sales charge (CDSC)*.

Exit load / CDSC are meant to help AMCs meet some of the selling expenses. These are permitted by SEBI, subject to the following conditions:

- If the exit load / CDSC is more than 1% of the redemption proceeds, it is to be added back to the scheme. Thus, it does not become available to the AMC to meet sales expenses.
- All the unit holders representing a portfolio would have to be subject to the same exit load structure.

Earlier, SEBI also allowed AMCs to charge to the scheme, initial issue expenses incurred for its launch. For example, if a 5-year scheme incurred Rs3crore for its launch, the amount could be charged to the scheme as Rs60lakh each year, for 5 years. The annual charge in turn would be split into a charge for every day. This kind of charge of initial issue expenses, to the scheme, over a period of time, was called *deferred load*.

Deferred load is no longer permitted by SEBI. However, some old schemes, which were permitted deferred load when they were launched, continue charging deferred load.

6.5 Offer Documents

The Offer Documents for mutual fund products are split into two –

- Scheme Information Document (SID), which has complete information about the scheme
- Statement of Additional Information (SAI), which provides information common across schemes, such as management of AMC, Trustees, Directors etc.

The document that is commonly available in the market is the Key Information Memorandum (KIM). It is a summary of the information contained in the offer documents. KIM is accompanied by an application form.

6.6 Investor Transactions (Normal Physical Mode)

6.6.1 Acquisition of Units by Investor from the Scheme

(Sale Transaction for the Scheme)

The first opportunity, for the investor to acquire units of a scheme, comes up in the New

Fund Offer (NFO). Here, the investor transacts at an issue price that is pre-determined by the AMC. It is generally equal to the face value of Rs. 10 per unit.

The investor can fill in the application form and pay the prescribed amount. If the investment is found valid, then the investor is allotted the units applied for. If not, the money is refunded.

The investor can avoid the problem of having to wait for a refund, by investing through the Application Supported by Blocked Amount (ASBA) mechanism. ASBA operation is similar to the facility in equity issues. The investor authorizes his bank to block the amount that is required to support his application. Thus, if the issue price is Rs10, and he is applying for 100 units, then Rs1000 will be blocked by his banker.

If units are allotted to the investor, the RTA intimates the banker. Accordingly, the banker releases the requisite application money to the scheme. If the amount blocked is in excess of the application money required, the excess is released to the investor. Since the money remains in the investor's bank account during this period, when the amount is blocked, the investor continues earning an interest. Further, delays in having to wait for a refund from the scheme can be avoided. Thus, ASBA is beneficial for investors.

Such acquisition of units by investors in the case of NFO, happens for both open-ended and close-ended schemes.

Further, in the case of open-ended schemes, after the scheme re-opens, investor can buy units from the scheme any day. This kind of acquisition of units by an investor from the scheme is a sale of units, as far as the scheme is concerned. In market parlance, this is a *sale transaction*; it happens at the *sale price*.

Close-ended schemes do not allow ongoing sale of new units.

6.6.2 Sale of Units by Investor to Scheme

(Re-purchase Transaction for Scheme)

An existing investor in an open-ended scheme can sell his units back to the scheme, any working day, after the scheme re-opens. He can do this, either for his entire holding or part of it. Further, instead of specifying the number of units he wants to sell, he can specify an amount that he wants to realize.

In market parlance, when an investor offers his units for sale to the scheme, he is said to *offer his units for re-purchase*. The *re-purchase* transaction happens at the *re-purchase price*.

Close-ended schemes do not, generally, offer the flexibility of such any-time re-purchase. However, some close-ended schemes offer a limited re-purchase facility to investors. Limits may be specified on the amount that can be re-purchased by an investor and / or by all investors together. This facility may be available only to original investors in the NFO.

Restrictions may also be imposed on when the re-purchase can be sought by investors, and how such re-purchase requests will be processed by the AMC.

6.6.3 Secondary Market Transactions in Units by Investor

Liquidity in units of close-ended schemes is offered through a listing of the units in the stock exchange. Thus, like shares, any investor can buy or sell units of close-ended schemes in the stock exchange.

As with shares, the investor places an *order* (to buy or sell) in the NEAT system, which matches the order with other *passive orders* (to sell or buy, as the case may be) in the system. If no match is found, the order becomes a passive order in the system for matching against future orders during the day (unless of course, it is an *immediate or cancel* order, in which case the unmatched order will lapse, without becoming a passive order).

Open-ended schemes offer the facility of ongoing sale and re-purchase, directly with the scheme. As an additional form of liquidity, units of open-ended schemes too can be listed in the stock exchange. The trading in units of such listed open-ended schemes is similar to that of close-ended schemes.

6.6.4 Redemption of Units on closure of scheme

Close-ended schemes have a fixed tenor. At the end of the tenor, the scheme is closed. On closure, the investor surrenders his units, and is paid the value of his unit-holding. Such transactions are called *redemption of units*.

Open-ended schemes too can choose to close, subject to requisite approvals. If that happens, the units would be similarly redeemed.

6.6.5 Additional Purchase by Investor

An investor buying units of a mutual fund scheme will fill the application form of the mutual fund. However, if he has already invested in some other scheme of the mutual fund, then the mutual fund would have opened a folio with the relevant details of the investor. In such cases of *additional purchase*, the investor does not need to fill the entire application form – he can fill a concise *transaction slip*.

When a mutual fund sends statement of accounts to investors, transaction slip with pre-printed folio number is attached. Transaction slips without the pre-printed folio number are available in offices of the mutual fund, distributors and investor service centres. They can also be downloaded from the website of the AMC.

6.6.6 Switch by Investor

When an investor moves his moneys from one scheme to another within the same mutual fund, it is called a *switch*. For the scheme into which the money goes, it is a *switch in*. It is a *switch out* from the scheme from which money is withdrawn.

6.6.7 Systematic Investment Plan

Equity markets are volatile. Attempts to time the market are rarely successful. Therefore, it is advisable to keep investing constant amounts at regular intervals (normally, a specific date of the month). Such an approach to investment is called *Systematic Investment Plan (SIP)* or *Rupee Cost Averaging*.

Whenever the market is up on the date of investment, the investor will receive fewer units. The investor will be compensated by receiving more units, whenever the market is down on the date of investment. Thus, the acquisition cost of the units is averaged during the SIP period. The investor does not get saddled with units, all bought at the market peak.

SIP can be easily handled through Electronic Clearing System (ECS) / Standing Instructions to the investor's bankers. Alternatively, the investor can leave post-dated cheques with the AMC, to cover future investments under the SIP.

6.6.8 Systematic Withdrawal Plan

Just as it is difficult for investors to time their entry into markets, it is also difficult for them to time their exit from markets. Investors do not want to end up selling all their units during a market crash. Selling investments steadily – constant amounts at regular intervals – protects the investor. This is a SWP.

If on the date of sale, the market is up, the investor will find that he is able to encash the same amount by selling fewer units; conversely, if the market is down on the date of sale, the investor will end up selling more units to realize the same amount. Over the SIP period, the investor is able to average the sale price of his units.

The investor can leave standing instructions with the AMC to operationalize the SWP. Thus, he does not need to give a separate instruction each month.

6.6.9 Systematic Transfer Plan

This is a combination of *switch in* and *switch out* done regularly. For instance, an investor may invest a large amount in a debt scheme, and leave instructions to systematically transfer, constant amounts each month, from the debt scheme to an equity scheme of the same mutual fund. Thus, on the said date of the month, each month, an agreed value of units in the debt scheme will be redeemed (*switch out*) and invested in the equity scheme (*switch in*).

6.7 Investor Transactions (Through the Internet)

Most AMCs have made arrangements to effect the above transactions through the internet. In order to avail of this facility, the investor needs to have a folio with the mutual fund. On this basis, the AMC or the RTA allot a Personal Identification Number (PIN). Using this, additional purchases as well as re-purchase of units becomes possible.

For the purchases, moneys can be transferred through National Electronic Funds Transfer (NEFT) or Real Time Gross Settlement (RTGS). Similarly, the mutual fund can directly transfer the proceeds of the re-purchase into the investor's bank account.

Some distributors have also made arrangements for their clients to do online transactions, similarly.

Besides, the transactions in the stock exchange for listed mutual fund schemes can be effected online.

6.8 Investor Transactions (NSE MFSS Channel)

This is discussed in the next Chapter.

6.9 Dividend Options

Most schemes offer multiple options. An investor needs to select, not only a suitable mutual fund scheme, but also the appropriate option within the scheme. The options offered, vary between schemes; they also depend on the prevailing tax provisions. Typically, investors find themselves having to choose between the following options:

6.9.1 Dividend Payout Option

In a dividend payout, the dividend is paid out i.e. the investor receives in his bank account, the dividend that is declared by the mutual fund scheme.

6.9.2 Growth Option

In a growth option, the mutual fund scheme does not declare a dividend. Therefore, the investor does not receive anything in his bank account, in the form of dividend. The profits earned in the scheme, remain invested in the scheme.

Investors, who need the money, can get their units re-purchased by the scheme. The re-purchase price will reflect the original investment by the investor in the scheme, as well as the subsequent performance of the scheme.

6.9.3 Dividend Re-investment Option

This is a hybrid of the two options mentioned above. The scheme declares dividends, from time to time. However, the dividend is not paid out to the investor; the investor is issued new units against such dividend.

The optimal choice between these options depends on the cash flow requirements of the investor, as well as the tax provisions, which vary from scheme to scheme.

Dividend, if applicable, is calculated on the face value of the unit – not its NAV. Most schemes have a face value of Rs. 10.

6.10 Dividend Mechanics

Suppose units of an equity scheme have face value of Rs. 10. The scheme has declared a dividend of 10%, for the first time since inception of the scheme. The record date for dividend is July 15, 20xx. The scheme's NAV before the dividend is Rs. 21 for all the options it has offered.

Unlike in the case of dividend payments by companies, dividends by mutual fund schemes do not call for approval of unit-holders. The board of directors of the AMC proposes a dividend. Once confirmed by the Board of Trustees, the scheme can proceed with the dividend payout on the record date.

The AMC (if it is handling the investor records by itself) or the RTA (most schemes choose to appoint a RTA) will pay the dividend on the basis of unit-holding records as on July 15, 20xx.

10% dividend payout amounts to a dividend of Rs. $10 \times 10\%$ i.e. Rs. 1 per unit.

Let us say, an investor holds 200 units of that scheme.

- If the investor had selected the dividend payout option, then the investor will receive 200 units \times Rs. 1 per unit i.e. Rs. 200 in the bank account.

Similarly, dividend will be paid to all investors. Since Rs. 1 per unit goes to all the investors who have selected the dividend payout option, the NAV of the scheme for the dividend payout option will fall by that amount. The revised NAV, called the ex-dividend NAV, will be Rs. $21 - \text{Rs. } 1$ i.e. Rs. 20 for the dividend payout option.

- If the investor had selected the growth option, then the investor will not receive anything in the bank account. The scheme's NAV will remain at Rs. 21.

This is the reason dividend option NAVs diverge from growth option NAVs after every dividend payment. Since dividends are not paid out in the growth option, its NAV would be higher than the dividend option NAV.

- If the investor had selected the dividend re-investment option, then the investor will not receive anything in the bank account. However, the dividend declared will be translated into additional units for the investor, at the ex-dividend NAV.

The investor will therefore receive $\text{Rs. } 200 \div \text{Rs. } 20$ i.e. 10 additional units.

Ex-dividend NAV will be Rs. 20, as in the case of dividend payout option.

6.11 Income Distribution Tax

The ex-dividend NAV calculations shown above are valid for equity schemes. In the case of debt schemes, income distribution tax is applicable, as follows:

- Investors who are individuals or Hindu Undivided Families
 - o 25% plus surcharge plus education cess, for liquid schemes.

With 5% surcharge and 3% towards education cesses, the total income distribution tax becomes $25\% \times 1.05 \times 1.03$ i.e. 27.0375%.

- o 12.5% plus surcharge plus education cess, for other debt schemes (Total = $12.5\% \times 1.05 \times 1.03$ i.e. 13.51875%)
- Other investors
30% plus surcharge plus education cess for all debt schemes (Total = $30\% \times 1.05 \times 1.03$ i.e. 32.445%)

The point to note is that income distribution tax is to be calculated on the actual dividend payout to the investor – not the total amount available for distribution.

In the earlier example, if the investor was company and the scheme was a debt scheme with dividend payout option, and Rs. 1 per unit i.e. Rs. 200 on the holding of 200 units was available for distribution.

Rs. 200 needs to be split between the dividend payout (which will go to the investor) and the income distribution tax (which will go to the income tax authorities). The calculations are as follows:

- $\text{Rs. } 200 \times (1 \div 1.32445)$ i.e. Rs. 151 will go to the investor
- $\text{Rs. } 200 \times (.32445 \div 1.32445)$ Rs. 49 will go to the income tax authorities.

Similarly, if the investor was an individual or HUF investing in a liquid scheme, the split would be:

- $\text{Rs. } 200 \times (1 \div 1.270375)$ i.e. Rs. 157.4 will go to the investor
- $\text{Rs. } 200 \times (.270375 \div 1.270375)$ i.e. Rs. 42.6 will go to the income tax authorities.

If the investor was an individual or HUF investing in a debt scheme other than liquid scheme, the split would be:

- $\text{Rs. } 200 \times (1 \div 1.1351875)$ i.e. Rs. 176.2 will go to the investor
- $\text{Rs. } 200 \times (.1351875 \div 1.1351875)$ i.e. Rs. 23.8 will go to the income tax authorities.

There is no income distribution tax for equity schemes.

6.12 Securities Transaction Tax (STT)

This is applicable to equities and equity-oriented funds, but not to debt and debt-oriented funds.

- STT on equity-oriented schemes of mutual funds

On scheme's purchase of equity shares in the stock exchange	0.125%
On scheme's sale of equity shares in stock exchange	0.125%
On scheme's sale of futures & options in stock exchange	0.017%

- STT on investors in equity oriented schemes of mutual fund

On investor's purchase of the units in stock exchange	0.125%
On investor's sale of the units in stock exchange	0.125%
On re-purchase of investor's units by the AMC	0.250%

If an investor offers his units at the applicable re-purchase price of, say, Rs.20. The equity scheme will pay the investor Rs. $20 \times (1 - 0.25\%)$ i.e. Rs. 19.95 per unit.

If it were a debt scheme, the investor will receive the entire re-purchase price of Rs. 20 per unit.

Note: An *equity-oriented fund* is a fund that invests at least 65% of its corpus in equities of domestic companies.

6.13 Cut-off Time Regulations

When an investor buys or sells shares in the secondary market, there is no financial implication on the company whose shares are being traded or its other shareholders. However, subscription to and re-purchase of units of a mutual fund scheme, affect the financials of the scheme; these transactions therefore affect the scheme's other investors.

- If investors are permitted to subscribe to new units of a scheme at a price lower than their intrinsic value, then the prior investors lose out.
- Similarly, if investors are able to offer their units for re-purchase at a price higher than their intrinsic value, the investors who continue in the scheme are cheated.
- If investors subscribe to or re-purchase units at their intrinsic value, then neither the prior investors nor the continuing investors are adversely affected.

Since the NAV changes daily, timing of the subscription (and repurchase) makes a difference to the transacting investor as well as other investors:

- Allowing an investor to invest at yesterday's NAV, if the market has gone up today, is again unfair.
- Similarly, it would be unfair to allow an investor to offer his units for re-purchase at yesterday's NAV, after the investor has seen a decline in the market today.

A few operational factors compound the problem:

- The scheme may receive a cheque for subscription to new units on Day T. But the money will be received in the scheme's bank accounts only on Day T+1 or Day T+2. By then, the market may change.
- Banks may credit the money into the account as of a "value date". But the funds may be available for investment by the scheme, only on the following day.
- Unscrupulous investors may bounce their subscription cheque if they see the market going down after the application for subscription has been sent.

Considering all these dynamics, SEBI has mandated detailed regulations on the applicable NAV for investors' transactions with various types of schemes in different situations. The applicable NAV depends on whether or not the investor's application for subscription / re-purchase was received before the specified "cut-off" timing. This is applicable to all mutual funds. It is to be uniformly applied to all investors. The only exceptions are:

- International funds
- Transactions in Mutual Fund units undertaken on a recognized Stock Exchange

Mutual Funds have to ensure that each payment instrument for subscription or purchase of units is deposited in a bank expeditiously by utilization of the appropriate banking facility. AMCs have to compensate any loss occasioned to any investor or to the scheme and/or plan on account of non-compliance.

6.13.1 Liquid Schemes & Plans - Subscriptions

The following NAVs are to be applied:

- Where the application is received upto 2.00 p.m. on a day and funds are available for utilization before the cut-off time without availing any credit facility, whether, intra-day or otherwise – the closing NAV of the day immediately preceding the day of receipt of application;
- Where the application is received after 2.00 p.m. on a day and funds are available for utilization on the same day without availing any credit facility, whether, intra-day or otherwise – the closing NAV of the day immediately preceding the next business day; and
- Irrespective of the time of receipt of application, where the funds are not available for utilization before the cut-off time without availing any credit facility, whether, intra-day or otherwise – the closing NAV of the day immediately preceding the day on which the funds are available for utilization.

"Business Day" does not include a day on which the money markets are closed or otherwise not accessible.

For allotment of units in respect of purchase in liquid schemes, it has to be ensured that:

- Application is received before the applicable cut-off time.
- Funds for the entire amount of subscription/purchase as per the application are credited to the bank account of the respective liquid schemes before the cut-off time.
- The funds are available for utilization before the cut-off time without availing any credit facility whether intra-day or otherwise, by the respective liquid schemes.

For allotment of units in respect of switch-in to liquid schemes from other schemes, it has to be ensured that:

- Application for switch-in is received before the applicable cut-off time.
- Funds for the entire amount of subscription/purchase as per the switch-in request are credited to the bank account of the respective switch-in liquid schemes before the cut-off time.
- The funds are available for utilization before the cut-off time without availing any credit facility whether intra-day or otherwise, by the respective switch-in schemes.

6.13.2 Liquid Schemes & Plans – Re-Purchases

The following NAVs are to be applied:

- Where the application is received up to 3.00 pm - the closing NAV of day immediately preceding the next business day; and
- Where the application is received after 3.00 pm - the closing NAV of the next business day.

6.13.3 Other than Liquid Schemes & Plans - Subscriptions

The following NAVs are to be applied:

- Where the application is received up to 3.00 pm with a local cheque or demand draft payable at par at the place where it is received - closing NAV of the day on which the application is received;
- Where the application is received after 3.00 pm with a local cheque or demand draft payable at par at the place where it is received - closing NAV of the next business day; and
- Where the application is received with an outstation cheque or demand draft which is not payable on par at the place where it is received - closing NAV of day on which the cheque or demand draft is credited.

In respect of purchase of units in Income/ Debt oriented schemes (other than liquid fund schemes and plans) with amount equal to or more than Rs. 1 crore, irrespective of the time of receipt of application, the closing NAV of the day on which the funds are available for utilization is applicable.

For allotment of units in respect of purchase in income/debt oriented mutual fund schemes/ plans other than liquid schemes, it has to be ensured that:

- Application is received before the applicable cut-off time (3 pm).
- Funds for the entire amount of subscription/purchase as per the application are credited to the bank account of the respective schemes before the cut off time (3 pm).
- The funds are available for utilization before the cut-off time (3 pm) without availing any credit facility whether intra-day or otherwise, by the respective scheme.

For allotment of units in respect of switch-in to income/debt oriented mutual fund schemes/plans other than liquid schemes from other schemes, it has to be ensured that:

- Application for switch-in is received before the applicable cut-off time.
- Funds for the entire amount of subscription/purchase as per the switch-in request are credited to the bank account of the respective switch-in income/debt oriented mutual fund schemes/plans before the cut-off time.
- The funds are available for utilization before the cut-off time without availing any credit facility whether intra-day or otherwise, by the respective switch-in income/debt oriented mutual fund schemes/plans.

6.13.4 Other than Liquid Schemes & Plans – Re-purchases

The following NAVs are to be applied:

- Where the application is received up to 3.00 pm - closing NAV of the day on which the application is received; and
- An application received after 3.00 pm - closing NAV of the next business day.

6.14 Official Points of Acceptance (PoA)

In order to ensure transparency in capturing the timing, SEBI has mandated official points of acceptance for receipt of these applications. Application from investors are to be received by Mutual Funds only at the official points of acceptance, addresses of which have to be disclosed in the Scheme Information Document and on Mutual Funds' websites.

The Official PoA are typically offices of the AMC and RTA. Offices of the DP can also be an Official PoA for re-purchase transactions. Offices of stock exchange brokers can be Official PoA for transactions routed through the stock exchange.

6.15 Time Stamping

- For every machine, running serial number has to be stamped from the first number to the last number as per its capacity before repetition of the cycle.
- Every application for purchase is to be stamped on the face and the corresponding payment instrument is to be stamped on the back indicating the date and time of receipt and the running serial number. The application and payment instrument should contain the same serial number.
- Every application for redemption has to be stamped on the face and on the investor's acknowledgment copy (or twice on the application if no acknowledgment is issued) indicating the date and time of receipt and running serial number.
- Different applications cannot be bunched together with the same serial number.

- Blank papers should not be time stamped. Genuine errors, if any, are to be recorded with reasons and the corresponding applications requests are to be preserved.
- The time stamping machine should have a tamper proof seal and the ability to open the seal for maintenance or repairs must be limited to vendors or nominated persons of the mutual fund, to be entered in a proper record.
- Breakage of seal and/or breakdown of the time stamping process has to be duly recorded and reported to the Trustees.
- Every effort should be made to ensure uninterrupted functioning of the time stamping machine.
- In case of breakdown, the Mutual Funds has to take prompt action to rectify the situation. During the breakdown period, Mutual Funds needs to adopt an alternative time stamping method that has already been approved by the Board of the AMC and the Trustee(s).
- An audit trail should be available to check and ensure the accuracy of the time stamping process during the said period.
- Any alternate mode of application that does not have any physical or electronic trail needs to be converted into a physical piece of information and time stamped in accordance with the time stamping guidelines.
- Mutual Funds need to maintain and preserve all applications/ requests, duly time stamped, at least for a period of eight years. They should be able to produce them as and when required by SEBI or auditors appointed by SEBI.

6.16 RTA Role

The RTA handles the following activities for mutual fund schemes:

- Handling the KYC documentation for new investors
- Banking the cheques and drafts received from investors and notifying the AMC
- Ensuring that moneys are received from bankers against ASBA applications
- Reconciling the moneys received in the bank with the applications
- Determining the units to be allotted to investors against their applications, based on NAV given by the AMC
- Opening new folios for new investors
- Allotting the new units to investors
- Intimating the depository for credit to investor's demat accounts, if the application is for demat units

- Printing the unit certificates and sending them to investors, in the case of application for physical units
- Processing the redemption requests received from investors and intimating the AMC
- In case redemption request specifies amount to be redeemed, then determining the number of units to be redeemed, based on NAV given by the AMC
- Issuing instructions to the bank for credit of redemption proceeds to unit-holders bank account
- Where direct credit is not possible, issuing the redemption cheque and sending them to unit-holders at their registered address
- Re-working the unit-holding of investors, after adjusting for new units sold and redemption of units
- Send SMS or other intimation to investors regarding the transactions executed
- Send regular Statement of Accounts (SoA) to unit-holders
- Process dividend calculations and make payments to investors, based on information regarding dividend declaration from the AMC
- Process requests from investors regarding change in bank mandate, change in address, nomination etc. as in the case of shares
- Maintain the register of unit-holders
- Enabling switches, SIP, SWP, STP and such other investor facilities offered in the scheme
 - o When an investor switches between growth option and dividend option, the units in the growth option will be redeemed and new units will be allotted in the dividend option. This can have tax implications.
 - o When an investor switches within the dividend option, between dividend payout and dividend re-investment, then it is treated as non-financial transaction, because the NAV of both options would be the same. There will be no tax implications.
- Send the financial statements to investors in physical or electronic form, as requested by investors
- Send notices to investors for any meetings of unit-holders, called by the AMC.
- Process the commissions payable to distributors on the applications procured by them

6.17 Distributors' Commission

SEBI has mandated a regime, where the distributor can recover commission from the investors. Thus, each investor can pay a commission based on the value he sees in the service offered by the distributor.

Besides, the AMC pays a commission, which can take two forms:

- *Upfront Commission* – a percentage on the amount invested by the client using the distributor as intermediary.
- *Trail Commission* – a percentage on the market value of the client's portfolio with the AMC. Needless to say, the market value factors in the appreciation or depreciation in the scheme portfolio.

These vary between AMCs. Even within the same AMC, they vary between schemes.

6.18 Bank Accounts

In order to ensure easier accounting and better control over transactions, multiple bank accounts are opened by the AMC for different purposes as follows:

- Collection accounts for investors applications. These are regularly accessed by the RTA
- Dividend accounts for payment of dividends. These again are regularly accessed by the RTA
- Redemption account for handling redemptions of investors. This is frequently used by the RTA.
- Settlement accounts for schemes' investment transactions. These are regularly accessed by the Custodian who handles the settlement for the schemes of the AMC
- Regular operating account for day to day activities of the schemes.

6.19 Other Back Office Activities

The sales support back office of AMC as well as distributors evaluates various schemes in the market place.

Self-Assessment Questions

- ❖ The prime mover behind setting up a mutual fund is
 - Trustee
 - **Sponsor**
 - SEBI
 - FII
- ❖ When an investor buys units from the scheme, it is called
 - **Sale**
 - Re-purchase
 - Redemption
 - NFO
- ❖ Which of the following is not permitted for mutual fund schemes?
 - **Entry Load**
 - Exit Load
 - CDSC
 - Deferred Load
- ❖ When an investor moves money from one scheme to another, it is called
 - SIP
 - STP
 - SWP
 - **Switch**
- ❖ Dividend, if applicable, is calculated on the face value of the unit – not its NAV.
 - **True**
 - False
- ❖ Which of the following is not an official POA?
 - **Office of mutual fund distributor**
 - Office of stock exchange broker
 - Office of RTA
 - Office of AMC

Chapter 7 **Mutual Fund Transactions through NSE**

NSE offers a low-cost distribution reach across the country, and abroad. Therefore, the role of brokers in mutual fund distribution has been increasing. The involvement of NSE brokers in different contexts is discussed below.

7.1 *Listed Schemes*

Under SEBI regulations, closed-end schemes are to be mandatorily listed. This is equally applicable for debt and equity schemes. The only exception is Equity Linked Savings Schemes (ELSS) schemes, which are not listed during the first three years after NFO. This is because investors in ELSS are not permitted to sell their units for three years.

The difference in transactions between open-end and closed-end schemes is important to understand:

- Acquisition of Units by the Unit-holder
 - o In an open-end scheme, the units are newly created by the scheme. This is called a "sale" transaction. It happens at the NAV.
 - o In a closed-end scheme, the pre-existing units change hands. It happens at a price that is discovered in the stock exchange.
- Extinguishment of Unit-holding
 - o In an open-end scheme, the unit-holder offers his units for "re-purchase". This is effected at the NAV less Exit Load (if applicable). On re-purchase, the units are cancelled.

The exit load, in percentage terms, is frozen when the unit-holder acquires the units. It may be different for different investors. For the same investor, the percentage may be different for various unit holdings in the same scheme, depending on when they were acquired.

Suppose an investor acquired 100 units of a scheme at Rs. 12 per unit on January 1, 2010 when the applicable exit load was 1%. 50 units were redeemed on June 6, 2011, when NAV was Rs. 15; balance was redeemed on October 5, 2011, when NAV was Rs. 17.

- The redemption price on June 6, 2011 for this investor would be Rs. 15 less 1% i.e. Rs. 14.85 per unit. The exit load is Rs. 0.15 per unit.
- The redemption price on October 5, 2011 for the same investor for the units (that were bought on the same day as the previous lot of units) would be Rs. 17 less 1% i.e. Rs. 16.83 per unit. The exit load is Rs. 0.17 per unit. To

clarify, the exit load is frozen in percentage terms, and is applied on the NAV on the re-purchase date.

- On the same day, another investor may have offered units for re-purchase. Suppose these units were acquired on a date other than January 1, 2010. On the acquisition date, the applicable exit load was 0.20%. The re-purchase price for this investor would be Rs. 17 less 0.20% i.e. Rs. 16.966 per unit.
- o In a closed-end scheme, the unit-holder sells the units to some counter-party at a price that is determined in the stock exchange. The units continue to exist. Only the name of the unit-holder changes in the scheme records.

Listed schemes (typically, closed-end) are traded through NSE's NEAT (National Exchange for Automated Trading), like any share. Buyers and sellers enter their orders through their respective Trading Members (TM). The NEAT system matches orders based on price and time priority. If a match is found, a trade is generated. The TM earns a brokerage as per the terms of the contract with the client.

NSE's Mutual Fund Service System (MFSS, discussed below) facilitates order collection (sale and re-purchase) for open-end schemes.

7.2 Exchange Traded Funds (ETFs)

Like any share or closed-end scheme, ETFs are listed in the exchange. Therefore, TM in the NSE can help clients buy and sell ETFs as part of their normal services.

Besides, market makers in ETF can benefit from two other streams of income:

- The buy-sell spread arising out the market making operations. If the market maker buys units from investors at Rs. 50.00 per unit, and sells units to investors at Rs. 50.60 per unit, a spread of Rs. 0.60 is earned for every unit so traded.
- Large investors subscribing to the ETF directly with the scheme, or offering their units for re-purchase to the scheme, will need to give or receive index securities in the same proportion as the index. There is scope to earn a brokerage, when these investors buy or sell index securities as part of the subscription or re-purchase.

Each ETF unit is defined to be equivalent to a certain proportion of the underlying index. For example, 100 ETF Units = 1 Nifty. In that case, if the Nifty is at 6,000, then the intrinsic value of each ETF Unit is Rs. 60.

7.3 Mutual Fund Service System (MFSS)

NSE launched India's first Mutual Fund Service System (MFSS) on November 30, 2009. Using NEAT MFSS, an investor can subscribe or redeem units of a mutual fund scheme, through eligible members of NSE.

Trading members of NSE who are AMFI Registration Number (ARN) holders, and who have passed the Mutual Fund Distributor certification examination of National Institute of Securities Market (NISM Series VA MFD) are eligible to participate in NEAT MFSS. They are called *participants*.

NEAT MFSS is open for trading between 9 a.m. and 3 p.m. on all business days of the capital market segment. Participants can make the service available for their registered clients.

Participants need to open a separate Bank account with any of the Clearing Banks identified by the Clearing Corporation. This will be the designated bank account for transactions under MFSS. Pay-in of funds for subscription is to be done through the designated bank account on T+1 basis, as per time lines specified by the Clearing Corporation.

Participants can choose between Physical mode and depository mode while capturing subscription / redemption requests on the MFSS. Securities settlement is effected through the RTA (if physical mode) or through the Depository (if Demat mode).

The steps in the transactions are as follows:

7.3.1 Subscription (Physical mode)

o T-Day activities

- Investor has to submit the following documents/details along with clear funds to the Participant:
 - Completed and Signed respective scheme Application Form
 - Copy of PAN Card of first holder
 - Copy of PAN Card of each additional holder in case of joint investment /either or survivor basis
 - Copy of KYC acknowledgement of all holders
 - Copy of Guardian's PAN Card in case investment is on behalf of minor
 - Folio No. in case the subscription is an additional purchase.
- The Participant verifies the application for mandatory details including PAN details and KYC compliant acknowledgment issued by CVL.
- After completing the verification, Participant enters the subscription order on the MFSS front-end system with the option of 'Physical' settlement.
 - The folio No (if available) is captured on the MFSS front-end.
 - The MFSS identifies each scheme uniquely in terms of Symbol & Series.
 - Subscription orders are created in terms of Amount.
 - Once the order is created, system generates a unique confirmation No. for the order.

- The investor receives a confirmation slip from the Participant. It contains unique confirmation number and date and time stamp of order entry generated from the MFSS system. Till the Participant provides allotment details to the investor, the order confirmation slip is proof of the transaction.
 - On allotment, the investor will receive Statement of Account from the RTA directly.
 - The Participant writes the unique confirmation number on the physical documents and delivers the same at any of the RTA /AMC offices as may be intimated from time to time.
 - Exchange validates the transactions on T day evening with the RTA, and any discrepancy in the transaction details is informed to the Participant on the same day evening.
 - The Clearing Corporation provides the Participants with funds obligation report end of day for all the valid transactions.
- o *T+1 Day activities*
- The Clearing Corporation of the Exchange debits the designated clearing bank account of the Participants for the required funds obligation on T+1 morning.
 - In case of shortage, the concerned Participant is provided an opportunity to identify transactions and provide details of the transactions for which payments have been received and transactions for which payments have not been received.
 - The fund collected from the bank account of the Participant is compared with the details provided by the Participant on the payment received status.
 - If the funds collected from the bank account of the Participant covers the details of the payments received as provided by the Participant, the same is further processed.
 - Wherever the funds collected from the bank account falls short of the amount indicated in the details provided by the Participant, the details are considered defective and are not further processed. In such cases, the funds collected, if any, are returned to the designated bank account of the Participant.
 - The Exchange / Clearing Corporation takes appropriate action including penalty on participants who fail to fulfil their funds obligation as required.
 - The Exchange notifies RTA for all such defective transactions and rejections due to non-payment of funds.
 - The RTA reverses such transactions for respective Participants. Transactions for other Participants who have fulfilled their funds obligations are processed by the RTA.

- The RTA intimates the allotment details for accepted transactions including folio numbers.
- Allotment information is provided to the Participants so that they can provide allotment details to the investor.

7.3.2 Subscription (Demat mode)

o T-Day activities

- The order is placed like a normal secondary market activity. The investor provides the depository account details along with PAN details to the Participant. KYC performed by DP is considered compliance with applicable requirements.
- Participant enters the subscription order on the MFSS front-end system with the option of 'Depository' settlement.
 - MFSS identifies each scheme uniquely in terms of Symbol & Series.
 - Subscription orders are created in terms of Amount.
 - Once the order is created, system generates a unique confirmation No. for the order.
- The investor receives a confirmation slip from the Participant. It contains unique confirmation number and date and time stamp of order entry, generated from the MFSS system. Till the Participant provides allotment details to the investor, the order confirmation slip is proof of the transaction.
 - Demat statement given by depository participant is deemed to be adequate compliance of the requirement of Statement of Account.
- Exchange validates the transactions on T day evening with the RTA as well as the depository. Any discrepancy in the transaction details is informed to the Participant on the same day evening.
- The Clearing Corporation provides the Participants with funds obligation report end of day for all valid transactions.

o T+1 Day activities

- The Clearing Corporation of the Exchange debits the designated clearing bank account of the Participants for the required funds obligation on T+1 morning.
- In case of shortage, the concerned Participant is provided an opportunity to identify transactions and provide details of the transactions for which payments have been received and transactions for which payments have not been received.
- The fund collected from the bank account of the Participant is compared with the details provided by the Participant on the payment received status.

- If the funds collected from the bank account of the Participant covers the details of the payments received as provided by the Participant, the same is further processed.
- Wherever the funds collected from the bank account falls short of the amount indicated in the details provided by the Participant, the details are considered defective and are not further processed. In such cases, the funds collected, if any, are returned to the designated bank account of the Participant.
- The Exchange / Clearing Corporation takes appropriate action including penalty on participants who fail to fulfil their funds obligation as required.
- The Exchange notifies RTA for all such defective transactions and rejections due to non-payment of funds.
- The RTA reverses such transactions for respective Participants. Transactions for other Participants who have fulfilled their funds obligations are processed by the RTA.
- The RTA intimates the allotment details for the accepted transactions including folio numbers.
- Allotment information is provided to the Participants so that they can provide allotment details to the investor.
- RTA credits the units to the pool account of the Participant, who will credit the depository account of the investor if payment has been received.

7.3.3 Redemption (Physical mode)

o T-Day activities

- Investor has to submit the following documents/details to the Participant:
 - Completed and Signed redemption request, stating the folio number.
 - Copy of PAN Card of first holder
 - Copy of PAN Card of each additional holder in case of joint investment
 - Copy of allotment statement / holding statement/ Statement of Account (SOA) displaying the scheme holdings to be redeemed
 - Copy of Guardian's PAN Card in case investment is on behalf of minor
- The Participant verifies the application for mandatory details, investor identity and verifies the signature on the application against the PAN signature of the signatory
- After completing the application verification, the Participant enters the redemption order on the MFSS system with the option of 'Physical' settlement.

- The MFSS identifies each scheme uniquely in terms of Symbol & Series.
 - For physical orders the folio No is captured on the MFSS front-end.
 - Redemption orders are created either in terms of Amount or Quantity for physical settlement.
 - Once the order is created system generates a unique confirmation No. for the order.
 - The investor receives a confirmation slip from the Participant. It contains unique confirmation number generated from the MFSS front-end system. This is proof of the transaction for the investor till the redemption proceeds are received from the registrar.
 - The Participant writes the unique confirmation number on the physical documents and delivers the same at any of the RTA /AMC offices as may be intimated from time to time.
 - Exchange validates the transactions on T day evening with the RTA and any discrepancy in the transaction details in terms of folio number etc.is informed to the Participant on the same day evening.
- o *T+1 Day activities*
- RTA carries out the redemption processing at its end and provides final redemption information to the Exchange on T+1.
 - The file contains information about valid and rejected redemption orders.
 - For successful redemptions, the file contains the redemption NAV, units redeemed, redemption amount, STT (if any).
 - Redemption information is provided to the Participant through files so that they can provide Redemption details to the investor.
 - The redemption proceeds are directly sent by RTA through appropriate payment mode such as direct credit, NEFT or cheque as decided by AMC from time to time, as per the bank account details recorded with the RTA.
 - It is the primary responsibility of the Participant to ensure completeness of the documents including filling up of the all Key fields by the investor before accepting the same for processing.
 - It is also the responsibility of the Participant to ensure identity and authentication of signature affixed based on the original PAN shown at the time of accepting the redemption application form. In case of joint holding, this is to be ensured by the Participant for all holders.

- In case the form has not reached to the RTA, the redemption request for such subscription will not be taken by the RTA and shall be rejected.

7.3.4 Redemption (Demat mode)

o T-Day activities

- Investor places order for redemption as currently followed for secondary market activities. The investor provides their depository account details along with PAN details to the Participant. The investor also provides their Depository Participant with Depository instruction slip (a copy of which is to be provided to the participant at the time of placing the redemption request) with relevant units to be credited to Clearing Corporation pool account same day before 4.30 p.m.
- The Participant enters the redemption order on the MFSS system with the option of 'Demat' settlement.
 - The MFSS identifies each scheme uniquely in terms of Symbol & Series.
 - Redemption orders are created only in quantity.
 - Once the order is created system generates a unique confirmation No. for the order.
- The investor receives a confirmation slip from the Participant. It contains unique confirmation number generated from the MFSS front-end system. This is proof of the transaction for the investor till the redemption proceeds are received from the registrar.
- Exchange validates the transactions on T day evening with the RTA / depository and any discrepancy in the transaction details in terms of DP Id etc. is informed to the Participant on the same day evening.
- Subsequent to the validation, Clearing Corporation will provide valid orders to depository to validate the delivery instructions (DIS) received from the investor and accept units received if they are equal to the valid transactions. The units thus received will be credited to the beneficiary account of the AMC(s) by the Clearing Corporation.
- For all units received through the depository system as above, the Exchange will inform the RTA same day with details of the addresses and bank mandate as captured on the depository system.

o T+1 Day activities

- RTA carries out the redemption processing at its end and provides final redemption information to the Exchange on T+1.
 - The file contains information about valid and rejected redemption orders.

- For successful redemptions, the file contains the redemption NAV, units redeemed, redemption amount, STT (if any).
- Redemption information is provided to the Participant through files so that they can provide Redemption details to the investor.
- The redemption proceeds are directly sent by RTA through appropriate payment mode such as direct credit, NEFT or cheque as decided by AMC from time to time, as per the bank account details recorded with the depository.
- The units will be extinguished by the RTA from the beneficiary account of the AMC(s)

The typical MFSS calendar is as follows:

Activity	Timings
T day	
Order capture for subscription and redemption on the MFSS	9.00 a.m. - 3.00 p.m
Subscription and redemption Order status report and Final funds obligation statement	5.30 p.m.
T+1 day	
Pay-in of funds	8.30 a.m.
Payment received and payment not received indication by Participants to Clearing Corporation	9.30 a.m.
Allotment and redemption information from RTA	2.00 p.m.
Credit in the depository account of the investor	End of day process at Depository
Redemption credit in the investor bank account/cheque dispatch	As per the current Mutual fund time lines adhered to by the RTA

In case of any dispute between the Participant and the investor arising out of the MFSS, the Exchange provides support for speedy redressal of the dispute through the Investor Grievance Cell.

Self-Assessment Questions

- ❖ Which of the following are not normally listed?
 - **Open end schemes**
 - Closed end schemes
 - ETF
 - All the above
- ❖ MFSS is meant for -
 - **Open end schemes**
 - Closed end schemes
 - ETF
 - All the above
- ❖ In the case of MFSS, pay in is to be done on
 - T
 - **T+1**
 - T+2
 - T+3
- ❖ MFSS allows only demat mode of settlement.
 - True
 - **False**
- ❖ MFSS is open for trading from
 - 9:30 am to 3:30 pm
 - 10 am to 5 pm
 - **9 am to 3 pm**
 - 9 am to 5 pm
- ❖ Purchase and sale of ETF is done through
 - **NEAT**
 - MFSS
 - Either of the above
 - None of the above
- ❖ MFSS settlement is effected through
 - RTA
 - Depository
 - **Either of the above**
 - None of the above

Chapter 8 Qualified Foreign Investors – Equity Shares

8.1 Background

Foreign investors (termed as Qualified Foreign Investors/ QFI) who meet prescribed Know Your Customer (KYC) requirements are permitted to invest in equity shares listed on the recognized stock exchanges and in equity shares offered to the public in India.

QFI means a person who fulfils the following criteria:

- Resident in a country that is a member of FATF or a member of a group (such as the Gulf Co-operation Council (GCC)) which is a member of FATF; and
- Resident in a country that is a signatory to IOSCO's Multi-lateral Memorandum of Understanding (MMOU) [Appendix A Signatories] or a signatory of a bilateral MOU with SEBI.

The FATF has 36 members, including 2 regional organisations – European Commission (EC) and GCC. The full list of members is as follows:

Argentina Australia Austria Belgium Brazil Canada China Denmark European Commission Finland France Germany	Greece GCC Hong Kong, China Iceland India Ireland Italy Japan Kingdom of Netherlands Luxembourg Netherlands New Zealand	Norway Portugal Republic of Korea Russian Federation Singapore South Africa Spain Sweden Switzerland Turkey United Kingdom United States
---	--	---

Residence in a country that has associate membership of FATF is not adequate to qualify as QFI.

Residence in the foreign country is to be checked on the basis of direct tax laws of that country.

A person cannot be QFI if he is resident in a country listed in the public statements issued by FATF from time to time on-

- jurisdictions having a strategic Anti-Money Laundering/Combating the Financing of Terrorism deficiencies to which counter measures apply;
- jurisdictions that have not made sufficient progress in addressing the deficiencies or have not committed to an action plan developed with the FATF to address the deficiencies.

"Person" under Section 2(31) of the Income Tax Act, 1961 includes:

- (i) an individual,
- (ii) a Hindu undivided family,
- (iii) a company,
- (iv) a firm,
- (v) an association of persons or a body of individuals, whether incorporated or not,
- (vi) a local authority, and
- (vii) every artificial juridical person, not falling within any of the preceding sub-clauses.

A QFI cannot be a person resident in India [as defined in the Income Tax Act, 1961 and Foreign Exchange Management Act, 1999(FEMA)].

Further QFI cannot be registered with SEBI as FII or Sub-account of FII or FVCI.

8.2 Permitted Transactions

QFIs are permitted to do the following transactions

- Purchase of equity shares in public issues, to be listed on recognised stock exchange(s).
- Purchase of listed equity shares through SEBI registered stock brokers, on recognized stock exchanges in India.
- Sale of equity shares which are held in their demat account through SEBI registered stock brokers.
- Subscription of equity shares against rights issues.
- Receipt of bonus shares or receipt of shares on stock split/ consolidation.
- Receipt of equity shares due to amalgamation, demerger or such other corporate actions, subject to the investment limits.
- Receipt of dividends.
- Tender equity shares in open offer in accordance with SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.
- Tender equity shares in open offer in accordance with SEBI (Delisting of Equity Shares) Regulations, 2009.
- Tender equity shares in case of buy-back by listed companies in accordance with SEBI (Buyback of Securities) Regulations, 1998

8.3 Investment Restrictions

- The QFI can transact in Indian equity shares only on the basis of taking and giving delivery of shares purchased or sold.
- Each transaction by QFI has to be cleared and settled on gross basis.
- QFI cannot issue offshore derivatives instruments/ participatory notes. A declaration and undertaking to this effect is to be obtained by DP from the QFI.

- The QFI and DP have to ensure that the total shareholding held by a QFI does not exceed five per cent of paid up equity capital of the company at any point of time. This investment limit is applicable to each class of equity shares having separate and distinct ISIN.
 - o In case a person invests in the same company through both QFI route and Foreign Direct Investment (FDI) route, the aggregate holding of the person in the company cannot exceed five percent of paid up equity capital of the company at any point of time.
 - o The investment limit is applicable to each class of equity shares having separate and distinct ISIN.
 - o This shall be subject to guidelines on FDI as prescribed by Government of India (GoI) and RBI from time to time.

8.4 Administration of Investment Limit

- The depositories have to put in place appropriate systems and procedures to monitor the above limit by using PAN and/ or other unique identity number of the QFI.
- The depositories need to administer and monitor, so as to ensure, that aggregate shareholding of all QFIs does not exceed ten per cent of the paid up equity capital of the company at any point of time, in respect of each equity share class having separate and distinct ISIN.
- The depositories have to jointly publish/ disseminate the ISIN wise and company wise aggregate shareholding of QFIs to public, on daily basis.
- The information regarding ISIN wise and company wise aggregate QFI shareholding has to also be provided by the depositories to the RBI in a manner and format as stipulated by the Reserve Bank of India from time to time.
- When the aggregate shareholding of all the QFIs in a company reaches 8% of the equity paid up capital, the company's name along with ISIN has to be published in caution list by the depositories and no fresh purchases can be allowed without prior approval of the depositories. The same is to be informed by the depositories to the DPs and recognized stock exchanges having nationwide terminals. The depositories have to also inform the DPs and such stock exchanges when any company is removed from the caution list.
- For fresh purchases by QFI in equity shares of companies in the caution list, prior approval of the depositories is to be obtained.

The QFI needs to make such request for prior approval to the concerned depository through the DP specifying therein the name of the QFI, PAN and other unique identification number relating to that QFI, number of shares to be purchased and the ISIN, by way of any mode

of communication as specified by the depositories in consultation with each other. The concerned depository has to provide the details of prior approval requests received by it to the other depository.

After market hours, the depository has to give prior approval to request for purchase of equity shares of companies in the caution list on a first-come-first-served basis in co-ordination with the other depository, based on time of receipt of the prior approval requests by the depositories.

The validity of the approval is for the next trading day only.

- In case the aggregate shareholding of the QFI exceeds the limit of ten per cent in respect of any ISIN, the depositories have to jointly notify the respective DPs regarding the breach along with the names of the QFI due to whom the limits have been breached. For this purpose, the stock exchanges have to provide the required information so as to enable the depositories to identify the transaction details of the QFI including the name of QFI, PAN and/ or other unique identification number relating to that QFI, purchase quantity and time or any other information as may be required by the depositories.
- In case the aggregate shareholding of the QFIs exceeds the limit of ten per cent for whatsoever reason, the QFI due to whom the limit is breached has to mandatorily divest excess holdings within three working days of such breach being notified by depositories to the DP. The DP has to obtain necessary authorization from the QFI at the time of account opening for such divestment of excess holdings.
- The DP has to provide on a daily basis, QFI wise, ISIN wise and company wise buy/ sell information and any other transaction or any related information to their respective depositories on the same day i.e the day on which the transaction was carried out, before the time stipulated by the depositories.
- The stock exchanges have to provide the details of paid up equity capital of all the listed companies, ISIN wise, to the depositories once in six months, and also provide information regarding change in paid up equity capital in any listed company, immediately.
- The stock exchanges have to develop a separate segment for intra QFI transactions in the equity shares of companies in the caution list, if they wish to buy without the prior approval of depositories. However, QFI who have obtained prior approval of the depositories may purchase equity shares in the normal segment of recognized stock exchanges.
- The stock exchanges/ depositories/ DPs are not permitted to levy any charges towards services relating to monitoring and administering of investment limits of QFI.

8.5 Other Conditions

- A QFI can open only one demat account with any one of the DPs. Purchase and sale of equity shares will be made through that DP only.
- In case of jointly held demat accounts, each of the joint holders has to meet the requirements specified for QFI and each is deemed to be holding a demat account as a QFI.
- Depositories/ DP need to have adequate systems to ensure the compliance of the same and perform KYC due diligence for each of the joint holders.
- The DP has to carry out necessary due diligence and obtain appropriate declarations and undertakings from QFI to ensure that no other demat account is held by any of the QFI as a QFI or in any other capacity such as NRI, before opening a demat account.
- The DP has to ensure that the same set of ultimate/ end beneficial owner(s) are not allowed to open more than one demat account as QFI. For this purpose, the DP has to carry out necessary due diligence and obtain appropriate declarations and undertakings from QFI.
- A QFI can open trading accounts with one or more SEBI registered stock brokers.
- Entities having opaque structure(s) such that the details of ultimate/ end beneficiary are not accessible or where the beneficial owners are ring fenced from each other or where the beneficial owners are ring fenced with regard to enforcement are not allowed to open demat account as QFI.
- In case of any direct/ indirect change in structure or beneficial ownership of the QFI, it has to bring the same to the notice of its DP, forthwith. The DP will assess the eligibility of that QFI afresh, before allowing it to undertake any further transactions.
- The QFI has to open a single non-interest bearing Rupee Account with an AD Category- I bank in India, for routing the receipt and payment for transactions relating to purchase and sale of eligible securities subject to the conditions as may be prescribed by RBI from time to time.
 - o 'Eligible securities' mean mutual fund units (under both direct and indirect route – explained in next Chapter), equity shares, corporate debt and any other security which is permitted for investment by QFI from time to time by GoI, RBI and SEBI.
- The QFI, if it so desires, can appoint a custodian of securities, who would be obligated to perform clearing and settlement of securities on behalf of the QFI client. However, no person shall be appointed as custodian by the QFI unless it is itself the qualified DP of the QFI and is also registered as custodian with SEBI under SEBI (Custodian of Securities) Regulations, 1996.
- The DP can open a demat account for the QFI only after ensuring compliance with

all the requirements as per PML Act, rules and regulations, FATF standards and SEBI circulars issued in this regard, from time to time. It will also ensure that QFI comply with all these requirements on an ongoing basis.

- The DP has to ask QFI to submit necessary information for the purpose of obtaining PAN. The DP can use the combined PAN cum KYC form as notified by CBDT for this purpose. Each QFI needs to obtain a separate and distinct PAN.
- The DP is permitted take any additional information/ documents from QFI other than those mentioned in the common PAN cum KYC form to ensure compliance with PML rules and regulations, FATF standards and SEBI circulars issued from time to time.
- The DP has to ensure that all the investor related documents/ records of QFI are available with the DP.
- The DP has to ensure that equity shares held by QFI are free from all encumbrances including pledge or lien etc. at all times.
- The DP shall, at all times, ensure compliance with laws, rules and regulations of the jurisdictions where the QFI are based.
- The DP has to ensure that the interests of other clients of DP are not adversely affected in any manner due to transactions done on behalf of QFI.
- In case of any penalty, pending litigations or proceedings, findings of inspections or investigations for which action may have been taken or is in the process of being taken by an overseas regulator against DP/ QFI, the DP has to notify such information forthwith, to the attention of SEBI, depositories and stock exchanges.

The DP has to mandate the QFI to furnish the details of any such penalty, pending litigations or proceedings, findings of inspections or investigations to it on an ongoing basis.

- In case a QFI desires to change the DP with whom he holds the demat account, he is allowed to operate a new demat account with another DP only after closure of the earlier demat account. At the time of opening a new demat account with a different DP, the QFI has to furnish the details regarding the existing demat account with the earlier DP and the details of the shareholdings in the earlier demat account.

Simultaneously, the QFI has to issue transfer instructions to the earlier DP with a copy to the new DP.

At any point of time, a QFI can operate through only one demat account with a DP.

- The stock exchanges have to amend Clause 35 of the listing agreement, so as to incorporate another class of investor to disseminate QFI shareholding in equity shares.

8.6 Transaction Flow

The transaction flow envisaged is as follows:

- Purchases
 - o The QFI will place a purchase order with the DP mentioning the name of the company and ISIN, number of equity shares, name of the stock broker and remit foreign inward remittances from the designated overseas bank account of QFI through normal banking channel in any permitted currency (freely convertible) directly to the non-interest bearing rupee account with the designated AD category - I bank.
 - o The DP in turn will forward the purchase order to the SEBI registered stock broker with whom QFI has opened trading account and remit the money to the broker's account after receipt of funds from QFI and as per the instructions of QFI.
 - o The DP has to ensure that equity shares purchased on behalf of QFI are credited into the demat account of that QFI on the pay-out date.
 - o In case of QFI's participation in public issues, the QFI has to provide instruction to the DP to make application for public issue. The DP, after obtaining necessary instructions from the QFI and subject to availability of funds in the non-interest rupee account of the QFI, will make application on behalf of such QFI and remit money to the issuer company.
- Sale
 - o On receipt of instruction from QFI containing name of the company and / or ISIN, number of equity shares and name of the stock broker, the DP has to place order for sale of equity shares only after verifying availability of such equity shares in demat account of that QFI.
 - o The proceeds on account of sale of equity shares made on behalf of QFI have to be credited into the non-interest bearing rupee account maintained with the designated AD Category 1 bank.
 - o The QFI can instruct the DP to make fresh purchase of eligible securities out of the funds lying in the non-interest rupee account of the QFI.

The transactions of QFIs, for all purposes, have to be treated at par with that of Indian non-institutional investors with regard to margins, voting rights, public issues etc.

Self-Assessment Questions

- ❖ Resident of which of the following countries cannot become a QFI?
 - Singapore
 - Dubai
 - **Mauritius**
 - UK
- ❖ In order to ensure that a QFI is not resident of India, which of the following acts are applicable?
 - FEMA
 - Income Tax
 - **Both the above**
 - None of the above
- ❖ QFI cannot be registered with SEBI as FII or Sub-account of FII or FVCI.
 - **True**
 - False
- ❖ The total shareholding of a QFI in an Indian company cannot exceed
 - 2%
 - **5%**
 - 8%
 - 10%
- ❖ The cut-off for putting a company's share in caution list for QFI investment is
 - 2%
 - 5%
 - **8%**
 - 10%
- ❖ How many demat accounts can a QFI open?
 - **1**
 - 2
 - 3
 - Any number
- ❖ How many trading accounts can a QFI have?
 - 1
 - 2
 - 3
 - **Any number**

Chapter 9 Qualified Foreign Investors – Mutual Funds

9.1 *Background*

The definition of QFI applicable to their investment in India has been discussed in the previous Chapter.

9.2 *Investment Limit*

QFIs can invest in schemes offered by Indian mutual funds, subject to the following limits:

- Total overall ceiling of US \$10 billion for investment by QFIs in equity schemes
- Total overall ceiling of US \$3 billion (within the existing ceiling of USD 25 billion for FII investment in corporate bonds issued by infrastructure companies) for investments by QFIs in debt schemes which invest in infrastructure debt of minimum residual maturity of 5 years.

For this purpose, the definition of infrastructure under the RBI's ECB guidelines is applicable.

- Once the QFI investment reaches US\$ 8 billion in equity schemes and US\$2.5 billion in debt schemes, the remaining limit is proposed to be auctioned by SEBI through a bidding process.

9.3 *Transaction Flow*

QFI investment is permitted through two routes as follows:

9.3.1 *Direct Route (Demat)*

Three parties are envisaged in this route – the QFI, qualified DP and the MF.

- A QFI is permitted to open only one demat account with any one of the qualified DPs. It shall subscribe and redeem through that DP only.
- For the purpose of account opening, MF can rely on the KYC done by DPs. It has to obtain the relevant records of KYC/ other documents from the DP. Further, the MF has to comply with PMLA, FATF standards and SEBI circulars issued in this regard from time to time on an ongoing basis.
- The QFI has to open a single non-interest bearing Rupee Account with an AD Category- I bank in India, for routing the receipt and payment for transactions relating to purchase and sale of eligible securities subject to the conditions as may be prescribed by RBI from time to time.

- The subscription process is as follows:
 - o The QFI places the order, mentioning the name of the scheme/MF, with its DP and remits foreign inward remittance through normal banking channel in any permitted currency (freely convertible), to the non-interest bearing rupee bank account.
 - o The DP in turn forwards the order to the concerned MF, and remits the money to the MF's scheme account on the same day as the receipt of funds from the QFI. In case of receipt of money after business hours, DP has to remit the funds to the MF scheme account by the next business day.
 - o MF processes the order and credits the units into the demat account of the QFI.
- The redemption process is as follows:
 - o The QFI can redeem, either through Delivery Instruction (physical/ electronic) or any another mode prescribed by the Depositories.
 - o On receipt of instruction from QFIs, DP processes the same and forwards the redemption instructions to the MF.
 - o Upon receipt of instruction from DP, MF processes the same and credits the non-interest bearing rupee account with the redemption proceeds.

9.3.2 Indirect Route (Unit Confirmation Receipts – UCR)

There are four parties involved – the QFI, UCR issuer (based overseas), SEBI registered Custodian (based in India) and the MF.

- MF appoints one or more UCR issuing agents overseas, and one SEBI registered custodian in India. UCR issuer appointed by MF acts as agent of the MF.
- MF has to seek no objection from SEBI before appointing any UCR issuer, and furnish the details and information sought by SEBI about the UCR issuer. SEBI reserves the right to seek additional information / clarification and direct specific action, including non-appointment / revocation of appointment of that UCR Issuing Agent.
- QFIs can subscribe / redeem only through the UCR Issuer.
 - o The MF mandates the UCR issuer regarding the requirements for KYC, customer due diligence process and documents and information to be collected from the QFIs.
 - o MF has to obtain the relevant records of KYC/ other documents from the UCR issuer in order to comply with FATF standards, PMLA and SEBI circulars.
 - o The units of the MF, denominated in rupees, are held as underlying by the custodian in India in demat mode, against which the UCR issuer would issue UCR to the QFIs.

- o MF has to ensure that for every UCR issued by the UCR issuer, Custodian in India holds corresponding number of units against it i.e. there will be one unit of MF scheme for every unit of UCR.
- o MF will receive money from UCR issuer, either in a foreign country by opening bank account overseas (in accordance with the relevant FEMA regulations), or in Indian rupees in the respective MF scheme account held in India.
- o Units purchased and redeemed through a UCR issuer are to be settled on gross basis. Under no circumstances can they be netted against other investors of the UCR issuer.
- o If the MF opens a bank account abroad, the investor transactions are as follows:
 - UCR issuer forwards the purchase / subscription order of the QFI to the MF/ Custodian. Upon receipt and transfer of funds to India, the MF issues units to the custodian. The custodian in turn confirms to the UCR Issuer to issue UCR to the QFIs.
 - In case of redemption, the UCR issuer confirms receipt of redemption request to the MF and the Custodian. Upon receipt of instruction, the MF processes the same and transfers the redemption proceeds to the MF's overseas bank account for making payment to the designated overseas bank account of the QFI.
 - In case of dividend payout, the MF transfers the dividend amounts to the MF's overseas bank account for making payment to the designated overseas bank account of the QFI.
- o If the MF does not open a bank account abroad, the transactions would flow as follows:
 - UCR issuer forwards the purchase order to the MF and Custodian, and remits the funds into MF scheme account (in rupee terms).
Upon receipt of funds; the MF issues units to the custodian.
The custodian in turn confirms to the UCR Issuer to issue UCR to the QFI.
 - In case of redemption, the UCR issuer confirms receipt of redemption request to the MF & Custodian.
Upon receipt of instruction, the MF processes the request and remits the redemption proceeds to the UCR issuer, which in turn remits the redemption proceeds to the designated bank account of the QFI.
 - In case of dividend payout, the MF remits the dividend amount to the UCR issuer, which in turn remits the dividend amount to the designated bank account of the QFI.

- In case of subscription, the MF has to allot units based on the NAV of the day on which funds are realized in the MF's scheme bank account in India.
- In case of redemption, units are to be redeemed on the day on which transaction slip/ instruction is received and time stamped by the MF, as per the applicable cut off time.
- The demat / UCR holding by QFIs is non-transferable and non-tradeable.
- Systematic Investments/ transfer/ withdrawals and switches too are not permitted for QFIs.

9.4 Other Conditions

Conditions prescribed in the case of equity investment regarding single demat account, non-interest rupee deposit account, PAN etc. are equally applicable for QFI investment in mutual funds. Besides the MF / DP has to:

- Ensure that units/ UCRs held by QFIs are free from all encumbrances i.e. pledge or lien cannot be created for such units.
- Ensure that the interests of existing unit holders of the MF schemes are not adversely affected due to the issuance of UCRs/ demat units to the QFIs.

Self-Assessment Questions

- ❖ Investment ceiling for QFI investment in Indian mutual fund schemes is
 - USD3bn
 - USD8bn
 - USD10bn
 - **USD13bn**
- ❖ QFI needs to open a demat account in India in which of the following routes for investment in mutual funds?
 - **Direct**
 - Indirect
 - Both the above
 - None of the above
- ❖ Unit Confirmation Receipt is a feature of which of the following routes for QFI investment in mutual funds?
 - Direct
 - **Indirect**
 - Both the above
 - None of the above
- ❖ KYC in the case of indirect QFI investment in mutual funds is handled by
 - Mutual Fund
 - DP
 - **UCR Issuer**
 - Custodian
- ❖ UCR is transferable to
 - Other QFI
 - Resident investors
 - Sub-accounts of FIIs
 - **None of the above**
- ❖ Which of the following is permitted for QFIs?
 - SIP
 - SWP
 - STP
 - **None of the above**