



## 9 SEBI, SHARE MARKET (PILLAR#1-C)

MCQs from SEBI/ Sharemarket /Financial Market / Companies Act Topic in UPSC Prelims- 2014 (1 MCQ), 2015 (0 MCQ), 2016 (2 MCQs), 2017 (0 MCQ), 2018 (1 MCQ).

A player should keep in mind the cost:benefit accordingly.

### 9.1 SECURITIES (प्रतिभूति)

A 'Security' means a certificate document indicating that its holder is eligible to receive a certain amount of money at a particular time. This could be a

Equity: Share certificate	Debt (ऋण): Bond / Debenture
Holder gets dividend from the profits of the company. If no profit, then no dividend.	Holder gets interest & principal irrespective of whether company makes profit or not.
called owners, proprietors of the company.	Creditors of the company.
Have _ _ _ _ claim during liquidation	_ _ _ _ claim.

### 9.2 FINANCIAL / SECURITIES MARKET: MEANING AND TYPES

It is the place where buying and selling of securities takes place.

Classification	Market Subtypes
Tenure: (अवधि)	1. _ _ _ _ _ Market (<1 year) मुद्रा बाजार 2. _ _ _ _ _ Market (1 year/>) पूंजी बाजार
Freshness प्राथमिक एवं द्वितीयक बाजार	1. _ _ _ _ _ <b>Market</b> (where new securities are issued for the first time). Helps a company /government to connect with the investor. It has no separate physical existence but classified for economic analysis. 2. _ _ _ _ _ <b>Market</b> (where the old securities are resold). It has physical existence such as Bombay Stock Exchange at Dalal Street, Mumbai. Provides liquidity and confidence to investors to buy new securities in Primary Market. (compared to a scenario if there was no market to resale used cars- तो कम लोग नई कार खरीदने जाएंगे.)
Settlement	1. <b>Future Market:</b> Where parties write contract today to buy/sell something at specific price on a future date 2. <b>Spot Market:</b> if instantly bought & sold.
Asset	- Depending on what asset is traded, market can be divided into Bond (Debt) market, Share (Equity) market, Gilt-Edged Securities Market, Foreign Currency Market, Commodity Market etc. - Presently, they have their individual exchanges where buying and selling occurs. But if there was a supermall where all these products were available in one place it will be called “_ _ _ _ _ <b>Exchange</b> ”. SEBI permitted BSE & NSE to launch such thing (2018).



### 9.3 DEBT INSTRUMENTS (ऋण उपकरण)

Creditors to company. First claim during liquidation. Assured interest irrespective of profit of company. These debt instruments can be classified into short-term vs long term.

#### 9.3.1 Short term debt instruments (लघु अवधि ऋण उपकरण)

- Tenure = less than 1 year. Usually 'unsecured' because not backed by any Asset.
- Usually sold at discount and re-purchased at \_\_\_\_\_. The difference between these two prices is the interest earned by investor.
- They're traded at **Money Market** and are (usually) 'negotiable & transferable' in nature i.e. lender can sell to third party, and third party can demand money from borrower.
- **Near Money** = Asset that is highly liquid = can be readily converted into cash.

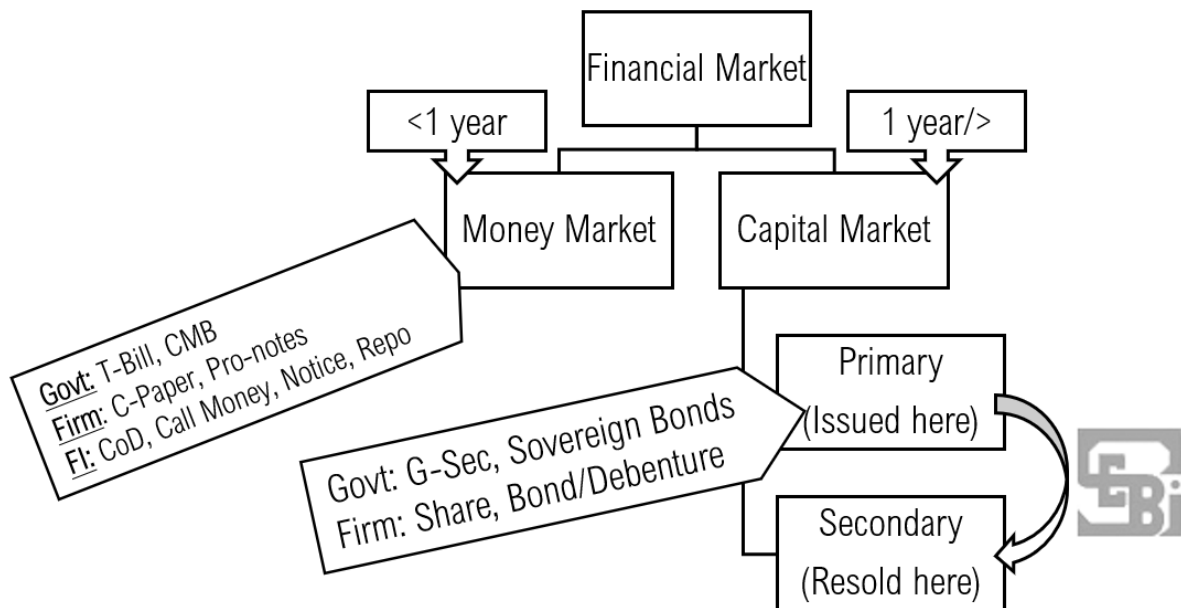


Table 1: Further sub-division based on who is the Borrower?

Borrower	Short term debt instrument
<b>Govt.</b>	1. State govt's treasury bills (14 days). But stopped since 2001. 2. Union govt's treasury bills (91, 182 and 364 days) & Cash Management bills (CMB: upto 90 days, started in 2009). 3. WMA (ways and means advances): it's the mechanism through which _____ lends money to Govt, for temporary short term needs when there is mismatch in receipt and expenditure of Govt. This WMA is not counted in Fiscal Deficit formula ( <i>More in Pillar#2: Budget</i> ).
<b>Company</b>	- Bill of Exchange, Hundi, Commercial Papers, Promissory Notes. - <b>Side note:</b> Currency Note is a 'Promissory Note' issued by RBI Governor however, he's not bound to pay any interest. Just promises to exchange it with other currency notes and coins of equal face value.
<b>Merchant to bank</b>	- Commercial Bill.
<b>Banks / NBFC</b>	Certificate of Deposits (जमा प्रमाण पत्र). RRBs and LAB can't issue.



<b>Call Money</b>	It's the interest rate when Financial Intermediaries (Banks/NonBanks) borrow for <b>ONE DAY</b> among themselves.
<b>Notice Money</b>	Same as above but for <b>2 to 14 days</b> .
<b>Repo</b>	Repo and Reverse Repo- already covered with Monetary Policy

**MCQ. Find Correct statements:(Asked in UPSC-Pre-2018)**

1. The Reserve Bank of India manages and services Government of India Securities, but not any State Government Securities.
2. Treasury bills are issued by the Government of India and there are no treasury bills issued by the State Governments.
3. Treasury bills offer are issued at a discount from the par value.

Ans Codes: (a) 1 and 2 only (b) 3 only (c) 2 and 3 only (d) 1, 2 and 3

**MCQ. Which of the following is /are example (s) of 'Near Money'? [UPSC-CDS-2016-I]**

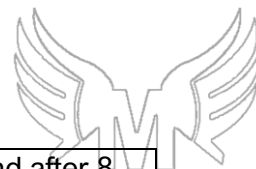
1. Treasury Bill 2. Credit Card 3. Saving accounts 4. Money Market Instruments

Answer codes: (a) 1 only (b) 2 only (c) 1, 2 and 3 (d) 1, 3 and 4

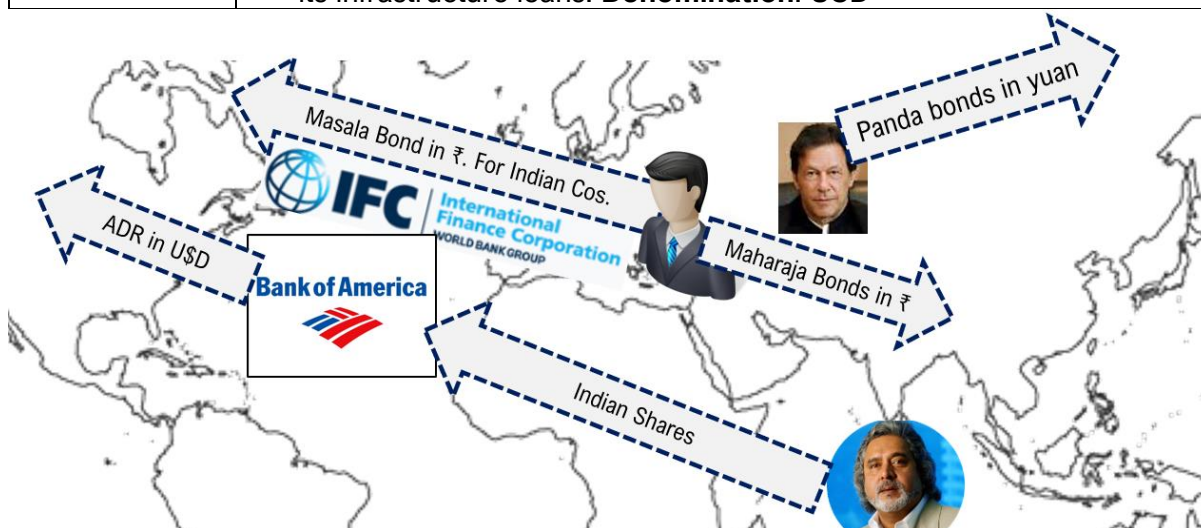
**9.3.2 Long Term Debt Instruments (दीर्घ-अवधि ऋण उपकरण)**

Tenure = 1 year/>. Further sub-division based on who is the Borrower?

Issuer	Objective? उद्देश्य?
<b>Modern day Government to borrow money</b>	<ul style="list-style-type: none"> <li>- <b>Government securities, Dated securities, Sovereign bonds</b> (संप्रभु स्वर्ण बांड), <i>Kisan Vikas Patra etc. (more in "Financial inclusion lecture)</i></li> <li>- Also called <b>Gilt Edged securities</b> (उच्च / अग्रिम दर्जे की प्रतिभूतिया) because repayment is assured by Government. (Although, give lower interest rate because of low risk to investor).</li> <li>- Global Credit Rating Agencies gives 'rating' to sovereign bonds. "___" is best and highest given to US Treasury Bonds. India's rating is ~"BAA" = moderate risk of default.</li> <li>- World's top three credit rating agencies- Fitch, Moody's and Standard &amp; Poor have pro-US/EU allegiance. Critics argue these 3 agencies do not give adequate upgradation to India, China, Russia despite the economic growth. So, India has proposed the ___ group to set up its own <b>independent credit rating agency</b>.</li> </ul>
<b>Modern day Govt. to curb Gold Consumption</b>	<p>Real Interest Rate (वास्तविक ब्याज दर) = Nominal (नामित) Interest minus Inflation. When Real Interest is negative, purchasing power _____ despite increase in money quantity in bank account. Then people prefer to park money in gold/real estate- which is not very beneficial to economy. So..</p> <p><b><u>Inflation Indexed Bonds (IIB-मुद्रास्फीति सूचकांकित बांड)</u></b></p> <ul style="list-style-type: none"> <li>- Launched in 1997, 2013, 2018 to provide positive _____ interest rate to household, thereby reducing the Gold consumption &amp; Current account deficit (CAD) &amp; weakening of rupee against dollar (else expensive crude-&gt;petrol, diesel inflation).</li> <li>- e.g. Inflation Indexed National Savings Securities-Cumulative (IINSS-C) with Interest Rate = CPI + 1.5% [and Principal also protected against inflation.]</li> </ul> <p><b><u>Sovereign Gold Bond (2015: संप्रभु स्वर्ण बांड)</u></b></p>



	<ul style="list-style-type: none"> <li>- They're denominated in gold grams. Annual interest 2.75%, and after 8 years you get the amount equivalent to prevailing gold prices at that time. <b>Benefit / challenges?</b> = Pillar#3, along with Gold Monetization Scheme.</li> </ul>
<b>Colonial era Govt.</b>	<ol style="list-style-type: none"> <li>1. <b>Coupon Bonds:</b> Contain detachable coupons- presented to the issuer to claim the interest.</li> <li>2. <b>Zero Coupon Bonds:</b> Are sold on discount and repurchased at face value, do not have any coupons.</li> <li>3. <b>Bearer Bonds:</b> Not linked to a PAN card, Aadhar card or passport, voter card or social security number. Anyone who presents it to the issuer, will get interest and principal. Usually issued during the war time.</li> </ol>
<b>ULB</b>	Urban Local Bodies issue <b>Municipal bonds</b> to borrow money from public.
<b>Companies</b>	<ul style="list-style-type: none"> <li>- <b>Bonds</b> (British Term), <b>Debentures</b> (American Term): Internal difference not important.</li> <li>- If the company has high risk of default on repayment, the Credit Rating Company will mark it as _ _ _ Bonds ("BB to D" Grade) e.g. IL&amp;FS. Such company will have to offer a very high interest rate next time.</li> <li>- Redeemable Bonds (मोच्च): will repay regular interest and will return principal on maturity. Irredeemable Bonds (अमोच्च): will pay only interest but no principal returned.</li> <li>- <b>Hybrid</b> instruments: Issued as "Bond" but can be converted into share. E.g. Optionally Fully Convertible Debentures (OFCD: वैकल्पिक रूप से पूर्णतः परिवर्तनीय ऋण पत्र).</li> </ul>
<b>BRICS Bank</b>	<ul style="list-style-type: none"> <li>- 2014- BRICS Nations had setup the New Development Bank (NDB, HQ: Shanghai, China). Later it launched <b>BRICS Bonds</b> to mobilize money for its infrastructure loans. <b>Denomination:</b> USD</li> </ul>



<b>IFC</b>	<ul style="list-style-type: none"> <li>- <b>Masala Bonds:</b> These _ _ _ _ denominated bonds issued outside India, to borrow money for Indian companies. World Bank's sister agency International Financial Corporation (IFC) launched &amp; named them 'Masala Bonds' to arrange loans for Indian private sector companies.</li> <li>- 2015: RBI allowed Indian entities to launch such Masala Bonds. 2017: NHAI also issued Masala Bonds in London stock Exchange to mobilize money for Indian Highway projects.</li> <li>- <b>Maharaja Bonds:</b> IFC-bonds are issued within India in ₹ denomination</li> </ul>
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<b>World Bank</b>	<ul style="list-style-type: none"> <li>- 2018: launched world's first Blockchain Offered New Debt Instrument called <b>Bond-i</b>.</li> <li>- Sold in Australia using _____ <b>blockchain</b> technology.</li> <li>- Local Manager: Commonwealth Bank of Australia (CBA) [Reserve Bank of Australia is separate].</li> <li>- Tenure: 2 years @~2% interest. <b>Denomination:</b> _____ Dollars, hence also called "<b>Kangaroo Bond</b>".</li> </ul>
<b>Non-Chinese in China</b>	<b>PANDA Bonds</b> is a bond issued by a non-Chinese entity (e.g. Pakistan or IFC or ADB) inside the Chinese Market to borrow money. <b>Denomination:</b> _____ -Renminbi
<b>Green bonds (हरित बांड)</b>	For renewable energy, pollution control, environment friendly Projects. <ul style="list-style-type: none"> <li>- World's first Green Bond launched by World Bank (2007)</li> <li>- India's first Green Bond launched by Yes Bank (2015)</li> <li>- BRICS Bank (New Development Bank) issued Yuan- denominated green Bonds (2016)</li> <li>- Indian Renewable Energy Development Agency (IREDA) launched India's first <b>Masala Green Bond</b> at London Stock Exchange (2018).</li> </ul>
<b>Blue Bond (नील बांड)</b>	A sub-type of green bond, where money borrowed for Climate resilient water / marine / fisheries projects. E.g. 2018- _____ issued world's first 'Blue Bond,' to expand its marine protected areas and fisheries sector.

**MCQ: With reference to 'IFC Masala Bonds', sometimes seen in the news, which of the statements given below is/are correct? (Asked in UPSC-Pre-2016)**

1. The International Finance Corporation, which issues them, is an arm of the World Bank.
2. They are the rupee-denominated bonds and are a source of debt financing for the public and private sector.

Answer Code: (a) 1 only      (b) 2 only      (c) Both 1 and 2      (d) Neither 1 nor 2

**MCQ. Which one of the following is a viable alternative to term-loans for raising debt finance by large publicly traded firms? (UPSC-IEnggS-2018)**

- (a) Shares      (b) Debentures      (c) Asset loans      (d) Gold loans

### 9.3.3 Electoral bonds (चुनावी बांड)

- ⇒ Announce Budget **2017**. Only \_\_\_\_\_ can issue at present, and in multiples of Rs.1,000, Rs.10,000, Rs.1,00,000, Rs.10,00,000 and Rs.1,00,00,000. [Notified by Dept. of Economic Affairs, Finance Ministry.]
- ⇒ **When?** For ten days at the start of each quarter. (January, April, July and October). However, in Lok Sabha election year, can sell for another 30 days.
- ⇒ **Who can buy?** Only an Indian \_\_\_\_\_ or Company registered in India -> deposit money in a bank account-> use that money to buy Electoral Bond, after giving certain KYC-documents. So, electoral Bond can't be bought **anonymously** or directly with **cash**.
- ⇒ Electoral Bonds can be donated only to a political party registered under Representation of the People Act (RPA), 1951 and which has secured \_\_\_\_\_ /> votes polled in last Lok Sabha or Vidhan Sabha elections.
- ⇒ **Validity?** Only \_\_\_\_\_ days from the date of purchase. Within that time, buyer must donate, and political party must deposit in its SBI (current) bank account. No interest payable.
- ⇒ **Characteristics?** Paper / Physical format (not DEMAT / electronic format). Bearer instrument (Donor or Recipient's name not mentioned), Promissory Note (promises to





transfer money in bank account) and an interest free banking instrument (zero interest payable to anyone). Can't sell it to third party, can't pledge it for loans.

⇒ **Benefits?** Transparency in political funding, Reducing influence of cash and black money in election, Confidentiality to donor.

Ignored for poor cost:benefit- Bond Yield, Yield To Maturity, bond yield's linkages with monetary policy, exchange rate, gold & crude prices.

## 9.4 EQUITY INSTRUMENTS (इक्विटी)

They're owners / proprietors of the company. If profit, they get dividend. Last claim during liquidation.

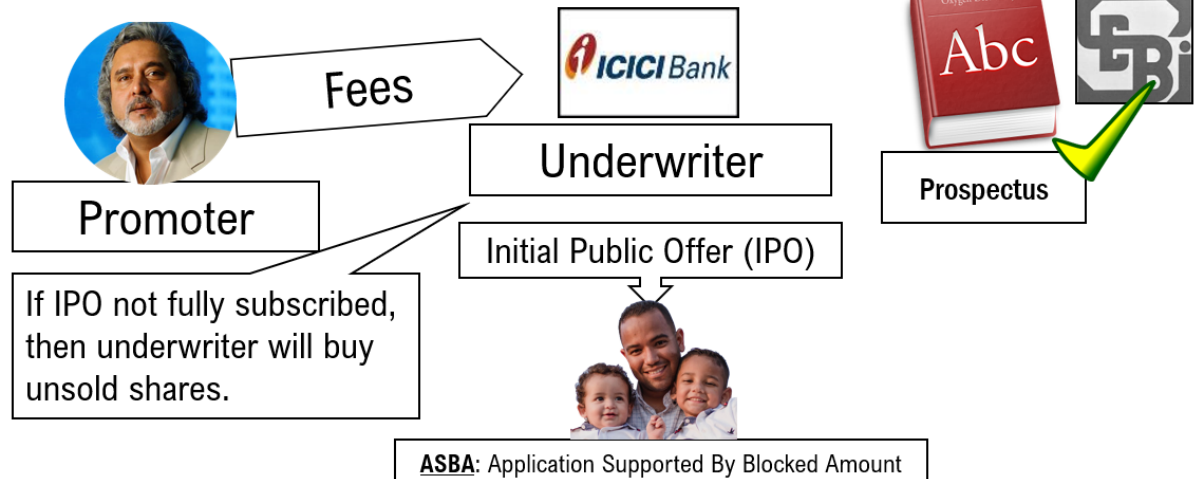
keywords	Features
<b>Ordinary shares</b>	Have voting power in the meetings of shareholders. Last claim during liquidation.
<b>Preferential shares</b>	अधिमान्य शेयर्स. During liquidation, these investors will be given money before the ordinary shareholders. Further subtypes: with or without voting powers.
<b>Sweet Equity</b>	Shares given @discount to directors & employees for their value addition to company [Amount is regulated under Companies Act]
<b>Penny stocks</b>	Shares whose market price remain excessively low compared to its face value, for a long period. Usually associated with some hidden game for money laundering through shell companies. PHDNotREQ
<b>Venture capital funds (VCF)</b>	Professional firms helping startup companies with seed capital. (could be debt / equity / hybrid)
<b>Angel Investors</b> ऐंजल निवेशक	Rich person helping startup companies out of his hobby, passion, profit motive or time pass. e.g Ratan Tata in Urban Ladder app. (could be debt / equity / hybrid)
<b>RGEES</b> <b>Started in 2012</b>	Rajiv Gandhi Equity Savings Scheme= Govt gives income tax benefit to people who invest in the share market for the first time. Discontinued by Budget-2017 (instead of renaming after DeenDayal).

**MCQ. What does 'Venture Capital' mean? (Asked in UPSC-Pre-2014)**

- (a) A short-term capital provided to industries
- (b) A long-term start-up capital provided to new entrepreneurs
- (c) Funds provided to industries at times of incurring losses
- (d) Funds provided for replacement and renovation of industries

## 9.5 METHODS OF ISSUING SHARES

Share have printed price on the certificate called **Face Value or Par Value** (सममूल्य). If they're sold at higher price than face value, it's called "**Premium Value**".



<b>Initial public offer (IPO)</b> <b>प्रारंभिक लोग निर्गम</b>	⇒ Company hires an underwriter (usually, a merchant bank, investment bank). ⇒ Underwriter drafts Red Herring Prospectus for SEBI approval. ⇒ Then, Underwriter invites application from public & sells them shares at face value or higher. (unlike T-bill, the shares not sold at discount on issuance). If less subscription, then underwriter will buy the unsold securities by himself.
<b>Follow on public offer (FPO)</b> <b>अनुसरण...</b>	⇒ If company had already issued shares previously, and now again issuing more shares then it is called up FPO. ⇒ Rights issue (अधिकार निर्गम): Company issues more shares but gives first right to existing shareholders to buy them, if they refuse then offered to outsiders.
<b>Other methods / terms</b>	Offer for sale / Private placement / Issuing bonus shares / share splitting / share swap / share buyback / PE Ratio etc. = NOT IMP. However, to satiate your curiosity you may self-study them from Investopedia.

#### 9.5.1 ADR/GDR: Indian shares in *Videshi* locker

- An Indian (or any non-American) company wants to mobilize money from American share market but does not want to go through the process of registration with the American regulator.
- Then Indian Company gives the Indian shares to an American Bank, and based on those Indian shares, the American Bank will create and sell American depositary receipts (ADR: अमरीकी निपेक्षागार रसीद) to American investors. **Denomination:** USD.
- **Global depositary receipt (GDR):** Same as above, but when single bank issues receipts for investors in multiple countries. **Denomination:** USD or Euro.
- **Bharat / Indian depositary receipt (IDR):** Similar concept- American (or any foreign) company wanting to mobilize money from Indian investors. Permitted since 2009-10. **Denomination:** INR (Rs.)

#### 9.6 STOCK EXCHANGES / SECONDARY MARKET

Shares are issued through IPO@Primary market. Then, they can be resold at Secondary market, commonly known as *Share market* or *Stock Exchange*.



- ⇒ World's Oldest: Amsterdam Stock exchange (1602) Netherlands.
- ⇒ Asia's Oldest: Bombay Stock Exchange (1875)
- ⇒ India's stock exchanges chronology: BSE->A'bad->Kolkata->NSE
- ⇒ Just like Banks have Core Banking Solutions for e-banking, Stock exchanges also have their electronic platforms for trading. E.g. **BOLT** (BSE's On-line Trading System) and **NEAT** (National Exchange for Automated Trading). They run using internet facility from **VSAT** (Very Small Aperture Terminal) Satellite.

### 9.6.1 DEMAT Account



- ⇒ If shares and bonds are traded in paper-form, then transactions are slow & prone to the risk of theft, forgery and fire.
- ⇒ Depository is an organization that stores the physical securities in its vault and allows investors to trade them in electronic (=DEMATERIALIZED) form.
- ⇒ Customer has to open Demat account in a depository-partner (DP) which can be a bank or an NBFC.
- ⇒ SEBI regulates them under the Depositories Act 1996. Notable examples are Central Depository services Limited (**CDSL**) and National securities depository Limited (**NSDL**: started by SBI, IDBI, UTI, NSE et al). NSDL also has RBI license to operate\_ \_

### 9.6.2 Types of Investors: Depending on Buying Capacity

1. **Qualified Institutional Buyers (QIB)**: Are those investors with expertise and financial muscle to make large investments in capital markets. E.g. Mutual Funds, Insurance Company, Foreign Venture Capital Funds etc. SEBI has separate registration norms for them.
  2. **Anchor investors**: They're QIBs who are offered shares before IPO-launch. This gives confidence to other investors to subscribe IPO.
  3. **Retail investor**: An individual investor who is not a QIB.
- Underwriter will keep quota for each category of investors, as per SEBI norms.

### 9.6.3 Types of Investors: Depending on Buying Behavior

1. **Jobbers (आढ़ती)**: Full time engaged in buying / selling securities using money from their own pockets. (Whereas brokers / commission agents buy/sell using money/shares of their clients).
2. **STAG (Male Deer)**: He buys newly issued securities **from primary market** & sells them in secondary market for quick profit.
3. **Bull (तेजड़िया)**: Optimistic speculator who hopes share prices will rise, so purchases (to sell them later at much higher price). Just like a bull tends to throw his victim up in the air, the bull speculator stimulates the price to rise.
4. **Bear (मंदड़िया)** – A pessimistic speculator who fears prices will fall so, he sells. A bear usually presses its victim down to ground. Similarly, the bear speculator tends to force down the prices of securities.





Further subtypes with various animal / bird names can be found on Investopedia but with poor cost : benefit in exam.

#### 9.6.4 Notable Indexes

- **SENSEX?**: Sensitive Index/ संवेदी सूचकांक. It's the weighted average of Free Float Market Capitalization (FFMC) of \_\_ companies, selected by BSE's "Index Cell".
- **NIFTY?** NSE index of 50 companies. **Nikkei?** Tokyo Stock Exchange index of 225 companies.

SENSEX – when does it go up	Goes down
RBI's soft /easy monetary policy -> cheap loan & credit cards -> consumers to spend more -> more profit to company-> more dividend –investor thinks “ <i>better I buy more shares to get more dividend</i> ”: Bullish	Tight monetary policy
Peace, Economic boom / prosperity, Political Stability	War, recession, political instability-> Bearish market.
When govt. hikes foreign investment limits	Inverse.
Merger-Acquisition, new product launches, Environmental permissions for new factory	CEO/MD arrest/FIR, Courts slapping fine, media exposing scandal...

**MCQ. In the parlance of financial investment, 'Bear' denotes [UPSC-CDS-2012]**

- (a) an investor, who feels that the price of a particular security is going to fall.
- (b) an investor, who expects the price of a particular share to rise.
- (c) a shareholder, who has an interest in a company, financially or otherwise.
- (d) any lender, whether by making a loan or buying a bond.

**MCQ. Which of the following statements is/ are correct? [UPSC-CDS-2012-I]**

1. NIFTY is based upon 50 firms in India.
2. NIFTY is governed and regulated by the Reserve Bank of India.
3. NIFTY does not trade in mutual funds.

Answer Codes: (a) Only 1      (b) Only 2      (c) Only 3      (d) 1 and 3

#### 9.7 \_\_\_\_\_ (SEBI)

- ⇒ भारतीय प्रतिभूति और विनियम बोर्ड, HQ- Mumbai
- ⇒ (1988) Formed by executive order -> (1992) Became Statutory Body -> powers increased through amendments in 1999 & 2014. Now it can order search and seizure, attachment of properties, arrest and detention.
- ⇒ **SEBI Board Composition:** Chairman + 1 officer from RBI + 2 officers from Union Government + 5 members appointed by Union Government.
- ⇒ **Chairman:** upto 5 years / 65 age. Reappointment possible. \_\_\_\_\_(IAS) initially given 3 years term in 2017, could be extended in future.
- ⇒ Regulates **Process** of issuing securities (Bonds, Shares, IPO, EPF, ReIT, INVITs, etc.) using the Securities Contracts Regulation Act, 1956 [SCRA: प्रतिभूति संविदा विनियमन]
- ⇒ Regulates **Places** (Depositories, Stock exchanges, Commodity Exchanges etc.)
- ⇒ Regulates **Persons** (individual investors, Brokers, Fund Managers, Public Limited companies etc.)
- ⇒ Regulates any Collective Investment Scheme (**CIS**) of ₹\_\_\_\_ cr/> [In the aftermath of SAHARA scam, Chit Fund scams.]



⇒ **Further appeal:** \_\_\_\_\_ (SAT)->Supreme Court. Same SAT also hears appeals against the orders passed by Insurance Regulatory Development Authority of India (IRDAI) and Pension Fund Regulatory and Development Authority (PFRDA).

⇒ “SCORES” online portal for complaint. Financial literacy of investors.

**SEBI has to protect the investors & increase their participation because:**

⇒ Share market scams erode public's hard-earned savings -> alcoholism, depression, suicide and other social ills.

⇒ Duped investors will shy away from share market & they may invest in gold / real estate = not very beneficial to economy.

⇒ If households don't participate in capital market- then corporate companies will have to approach the banks to get more loans. But banks' lending capacity is limited by CRR, SLR, PSL, NPA, PCA= bottleneck in factory expansion, job creation, and economic growth.

### 9.7.1 SEBI Reforms

⇒ Harshad Mehta (1992), Ketan Parekh (2001) arranged money from banks, used it for rigging the share prices & make windfall gains during bull-runs by other investors. Once the prices crashed, small investors suffered. To prevent such scams, SEBI introduced \_\_\_\_\_ **System**, wherein if fluctuation in the share prices is more than “x%” then stock exchange will have to stop trading for “y minutes / hrs”.

⇒ **Badla System/Carry forward system:** It's buying of shares using borrowed money and making promises & carrying forward the settlement for upto 72 days. This helped scamsters so SEBI discontinued it (2001) & introduced **(T+2) rolling settlement system** i.e. after trade is conducted, the parties must settle it within two working days (= buyer pays money, seller gives shares/bonds/securities).

⇒ Rupal Panchal (2005) opened multiple fake DEMAT accounts to increase the chances of getting share allocations in IPO. Then she'd sell such shares in stock-exchange for higher prices. Subsequently, SEBI made PAN Card (issued by Income Tax Dept) compulsory for opening DEMAT Accounts. SEBI also introduced **ASBA** (\_\_\_\_\_) - it allows the underwriter to block the amount in IPO-investor-applicant's bank account, but only IF shares allotted to the applicant, his bank money will be deducted. ASBA-Benefits:

- (1) only serious investors with sufficient bank balance can apply.
- (2) investor continues to earn bank interest on his blocked amount until the process of IPO-share allotment is over.

⇒ **Dabba Trading / Bucketing / Box Trading:** While share trade occurs at stock exchange linked with DEMAT accounts, the Dabba Trades occur in the unofficial books/ledgers of a broker. He may or may not execute those orders in actual DEMAT account. Investor prone to scam, govt deprived of taxes hence SEBI declared it illegal.

⇒ **Insider Trading:** Whenever company launches new products, wins unique patents, or undergoes merger and acquisition- its share prices will increase. If a person associated with company uses such confidential information for buying/selling shares to make windfall gains. Such insider trading is illegal.

⇒ \_\_\_\_\_ **Trading (भेदिया लेनदेन):** Some large brokers / companies use algorithmic trading computer programmes to automatically buy / sell securities at a speed and frequency that is impossible for a human trader. This can be misused for manipulating the share prices. Therefore, SEBI issued technical measures e.g. a single broker / investor can't place more than 100 online orders per second.



### 9.7.2 Commodity Market, FMC, SEBI merger

- ⇒ A commodity market / exchange (वस्तु बाजार) is a place where buyers and sellers trade goods in bulk such as food grains, precious metals or energy resources (oil / gas)
- ⇒ **“Commodity Futures”**: Type of contract for future delivery and settlement of commodity e.g. “on 1/1/2019, I shall deliver you 500 quintals of wheat at X price”.
- ⇒ Commodity exchanges were under a statutory regulator \_\_\_\_\_ (FMC) under the ministry of Consumer Affairs and Public Distribution. But Jignesh Shah generated fake receipts without any commodities in the warehouses & traded at NSEL-commodity exchange. FMC failed to prevent scam-it was transferred to Finance Ministry and ultimately merged with SEBI (2015).

### 9.7.3 Misc Bodies

<b>FSDC (2010)</b>	<ul style="list-style-type: none"> <li>- Financial Stability &amp; Development Council (वित्तीय स्थिरता और विकास परिषद.) Chairman – Finance Minister. Other members – 1. RBI Governor 2. SEBI chief 3. IRDAI chief 4. PFRDA chief.</li> <li>- Functions? Supervision of the economy, large financial conglomerates, coordination among the financial regulators, financial literacy and financial inclusion.</li> <li>- Secretariat assistance by: Dept. of _____</li> </ul>
<b>FSB (2009) HQ: BASEL</b>	<ul style="list-style-type: none"> <li>- Financial Stability Board (वित्तीय स्थिरता बोर्ड) is a brainchild of G20.</li> <li>- Function? Financial monitoring at global level., Coordination between national financial regulators bodies.</li> <li>- India has 3 seats in FSB: 1) Secretary of Department of Economic Affairs (IAS) 2) Dy. Governor of RBI 3) SEBI chairman</li> </ul>
<b>FATF (1989) HQ: _____</b>	<ul style="list-style-type: none"> <li>- Financial Action Task Force (वित्तीय कार्रवाई कार्यदल) is a brainchild of G7, with HQ@_____. India became member in 2010.</li> <li>- <b>Function?</b> Combating Money laundering and terror finance.</li> </ul>

**MCQ. With reference to 'Financial Stability and Development Council', find correct statement(s): (Asked in UPSC-Pre-2016)**

1. It is an organ of NITI Aayog.
2. It is headed by the Union Finance Minister
3. It monitors macro-prudential supervision of the economy.

Answer Codes: (a) 1 and 2 only      (b) 3 only      (c) 2 and 3 only      (d) 1, 2 and 3

## 9.8 INVESTMENT FUNDS

### 9.8.1 Mutual fund (MF: म्यूचुअल फण्ड ) for aam-aadmi

- ⇒ is an Asset Management Companies (AMC-NBFC) that pools savings of (retail) investors and gives them “Units”. MF Manager then parks the money in securities & builds his ‘portfolio’.
- ⇒ Whatever dividend/ interest is generated from the portfolio, is distribute among investors in the proportion of their units.
- ⇒ Investor has to pay Entry Load = fees for joining, Exit Load = Fees while quitting. SEBI regulates these fees.
- ⇒ Due to the low deposit rates in banks, people invested money in mutual funds however post-IL&FS crisis, charm declining because Mutual Funds are subject to such market risks.



### 9.8.2 Hedge Fund (हेज फण्ड) for rich-aadmi

- ⇒ Special type of Mutual Fund meant for HNI (High Net Worth Individual) who want high risk high return. SEBI norms: Minimum investment per person is ₹1 crore.
- ⇒ Hedge Fund manager will invest their money in Junk Bonds, Risky assets; he'll do risky trading activities such as Arbitrage, Leverage, Short Selling etc. to generate maximum return. (how is that done in real life = UPSC-CSE not for recruitment of HF managers.)

### 9.8.3 REITs / InvITs: for rich-aadmi

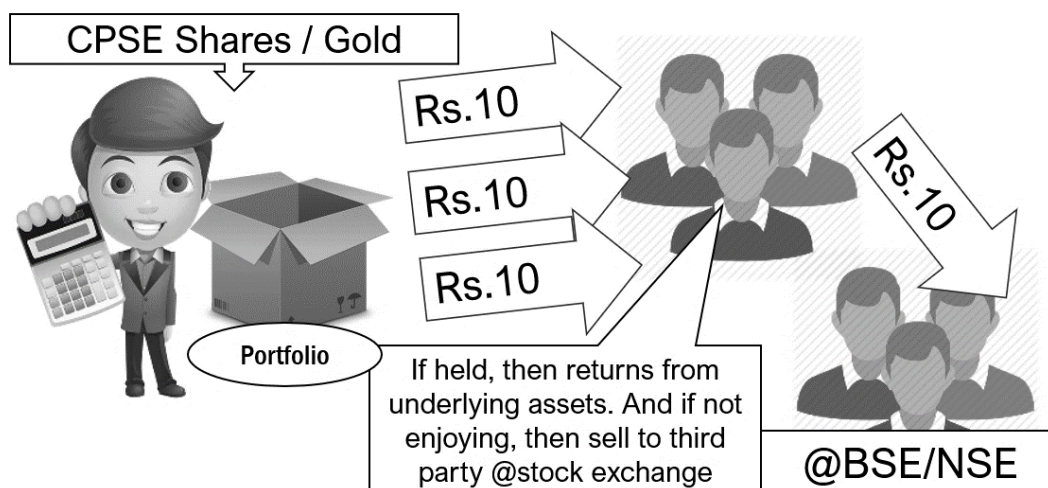
	REITs: (Real estate investment trusts)- (भू-भवन संपत्ति निवेश न्यास )	InvITs: infrastructure investment trusts-(अधिसंरचना निवेश न्यास )
<b>Who can invest?</b>	HNI / institutions: Min. ₹2 lakh investment per application	₹10 lakh.
<b>Manager parks the money in?</b>	in real estate projects that are about to complete. He'll earn income from rent / sale.	In airport, highway, thermal plants, gas grid etc. He'll earn from toll collection at highways, services fees at airports etc.
<b>Example</b>	Blackstone-Embassy group	IRB, india-grid

#### Benefits of REITs and InvITs-

- Stressed developer gets new finance to finish the project while HNI gets new opportunity to invest his money, and he may also sell the units to third party via stock exchange.
- SEBI permitted these instruments in 2014. Later SEBI relaxed technical norms related to capital, leverage, issue size but they are not important for us.

### 9.8.4 CPSE-ETF: Exchange Traded Funds

- **Disinvestment (विनिवेश):** government sells its shares from Central Public Sector Enterprises (CPSE: केंद्रीय सार्वजनिक क्षेत्र के उद्यम) but does not reduce its shareholding below 51%. If Govt's shareholding reduced below 51%, then it is called **Privatization** (निजीकरण).
- 2014: Government wanted to disinvest 10 CPSE. If govt tried to sell the shares individual company-wise, it would be more time consuming, and govt may not get good prices for each company.





- So, the CPSE-shares were given to fund manager Goldman Sachs - who created new securities out of it, called “Exchange Traded Funds”, and made a “New Fund Offer (NFO)” to the public to subscribe to these securities at Rs.10 per unit.
- If an investor holds the ETF- he will get returns from the dividend generated by those CPSE-companies in the backend. If he can also sell these ETF to a third party via stock exchange, hence are called Exchange Traded Funds.
- **BHARAT-22:** Same ETF funda, Govt wanted to disinvest shares from 22 companies including CPSE, PSBs and UTI using ICICI Prudential as fund manager (2017-18). However, PSB-NPA problem = poor dividends = BHARAT-22 not giving good returns, so, investors response was lukewarm.
- **Gold-ETF:** Investors give money-> manager buys gold for safekeeping and trades it depending on price movements-> returns are divided among the unit-holders. In between, the investor may sell his Gold-ETF to third party via Stock Exchange therefore they're also Exchange Traded Fund.

### 9.8.5 Alternative investment funds (AIF)

It's a technical classification under SEBI norms:

- **AIF Category I:** They generate \_\_\_\_\_ spillover effects on the economy. Example: Venture Capital Funds, Angel investors fund, SME Funds, social venture fund, Infrastructure funds. SEBI norms are easy on them.
- **AIF Category II:** Neither in Cat-1 nor in Cat-2 E.g. Private Equity or debt fund.
- **AIF Category III:** They undertake excessive risk to generate high returns in short period of time. E.g. \_\_\_\_\_ Funds. SEBI norms are stricter on them, else they may destabilize the capital market.

## 9.9 FORWARD / FUTURE CONTRACTS & CALL / PUT OPTION

- A Forward / Future contract is a customized contract between two parties where settlement takes on a future date at a price/quantity agreed upon today. E.g. *on 1/1/2019 I shall sell you 100 nos. of Infosys shares at ₹1000 each.*
- In such contracts, there is risk of other party not honoring commitment if he's getting better deal elsewhere in the future. So, to protecting (=hedging) themselves, they may buy “Option” from a third party by paying fees.
- Option is a type of insurance for executing the forward/future contract in a manner beneficial to them e.g. *I'll sell you for ₹1000 on X date, & you must buy, but if I'm getting another buyer who is willing to pay ₹1500 then I may not sell you & you can't compel me.* Such ‘insurance options’ are further subdivided into **Call Option and Put Option**, their internal-difference-not imp. for UPSC.

**MCQ. Which one of the following terms is used in Economics to denote a technique for avoiding a risk by making a counteracting transaction? [UPSC-CDS-2016-I]**

- (a) dumping                      (b) Hedging                      (c) Discounting                      (d) Deflating

## 9.10 DERIVATIVES & SWAPS

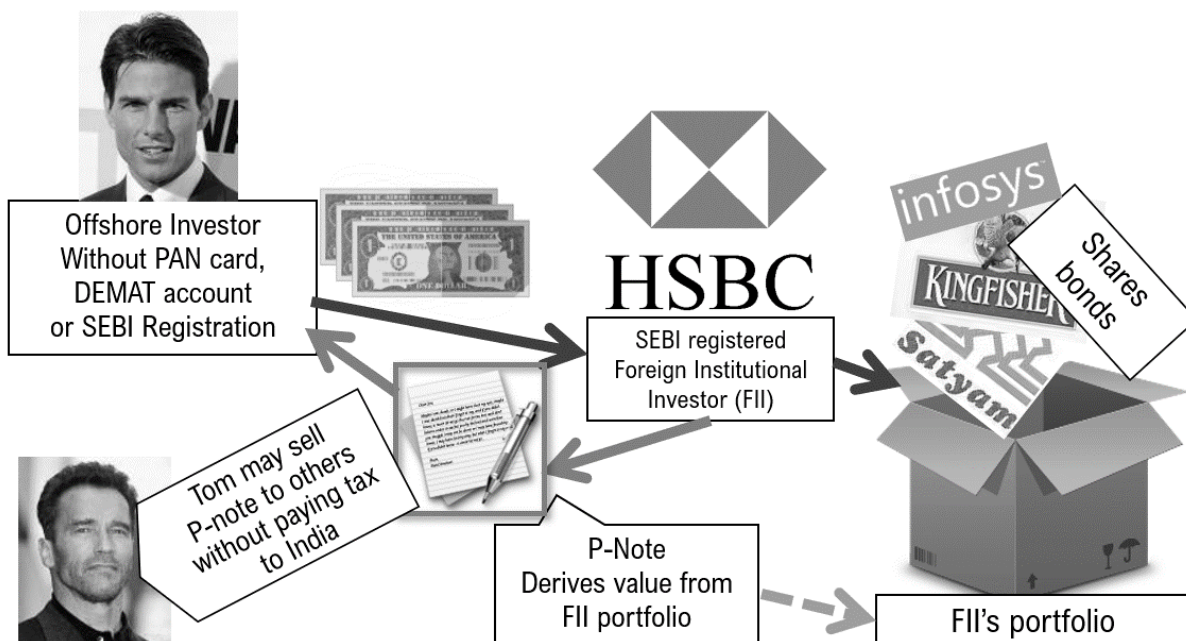
- ⇒ A **derivative** is a contract whose value is derived from the value of another underlying asset which could be a share, bond, commodity or currency. They're usually generated by the process of ‘securitization’. E.g. NHB taking loan papers from banks, using them to generate new Mortgage Backed Securities.





- ⇒ **SWAP**: is derivative instrument to swap one financial asset with another financial asset (usually) to reduce the risk e.g. Currency Swap Agreement between two countries to protect themselves against dollar volatility (more in Pillar#3).
- ⇒ **Similarly, there are Credit Default Swap agreement** against the risk of default, **Interest swap agreement** to protect against volatility in interest rates. But their mechanisms NOT IMP.

#### 9.10.1 Participatory notes (P-Notes: पार्टिसिपेटरी नोट्स)



- A foreigner wishes to invest in India but does not want to go through the hassles of registering with SEBI, getting PAN card number, opening a DEMAT account etc. So, he will approach a SEBI registered foreign institutional investor (FII) such as Morgan Stanley, Citigroup or Goldman Sachs. He'll pay them & instruct them to purchase particular shares and bonds and store them in their Demat account. Then FII will give him P-Notes, and he'll receive interest and dividend accordingly. He may also sell those P-notes to a third party.
- P-Notes are \_\_\_\_\_ that derive the value from the underlying Indian shares and bonds.

#### **P-Notes considered harmful to Indian economy because:**

- P-note investors are not directly registered with SEBI, the identity of the actual investor and source of funds remain disguised= chances of \_\_\_\_\_
- If P-Note owner sells his P-Notes to another foreign investor, Government of India will be **deprived of taxes**. (Compared to a scenario where Indian share owner is selling his shares to another Indian investor, then government gets securities transaction tax and capital gains tax on his profit, & he can't dodge it because DEMAT accounts linked with \_\_\_\_\_ card. *More on PAN card@Pillar#2->BlackMoney*)
- Therefore, SEBI is tightening the control P-Notes e.g. "X" category of FIIs can't issue P-Notes. "Y" category of FII can issue P-Notes but every time they issue P-notes-they'll have to deposit \$1,000 to SEBI etc.



## 9.11 COMPANY TYPES

### 9.11.1 Company types based on incorporation

<b>Chartered Companies</b>	Setup by a charter given by a king / queen. E.g. East India Company in _____. चार्टर्ड कंपनिया
<b>Statutory Companies</b>	Setup by by Special Acts of Parliament or Vidhan Sabha. E.g. RBI, LIC, SBI. वैधानिक कंपनिया
<b>Registered Companies</b>	Registered under The Companies Act, 1956 (and later 2013) e.g. Tata Motors, Infosys. पंजीकृत कंपनिया

### 9.11.2 Company types based on Ownership

<b>Holding Company / नियंत्रक कंपनी</b>	<b>Subsidiary Company / नियंत्रित कंपनी</b>
A company that owns majority shares in another company. E.g. Tata Sons Ltd. holds majority shares of Tata Consultancy Services (TSC), Tata Steel, Tata Sky etc	A company that is controlled by a parent Holding Company. E.g TCS, Tata Steel, Tata Sky are subsidiary companies of Tata Sons.
<b>Government / Public Sector / सार्वजनिक</b>	<b>Private Sector / निजी क्षेत्र की</b>
When Government owns 51%> shares. Examples: Steel Authority of India (SAIL), India Post Payment Bank (IPPB)	When private parties own 51%>. E.g. Reliance, Adani, Tata

### 9.11.3 Company types based on number of members

	<b>Private Ltd.</b>	<b>Public Limited Company (Companies Act 2013)</b>
<b>Members</b>	Min. 2 to Max. 200	Min. 7 to Max. unlimited number (depending on how many people buy shares)
	Can't	⇒ A public ltd. company can invite public to subscribe to its shares and bonds. ⇒ If their shares are listed on a stock exchange (BSE, NSE etc), it's a ' <b>Listed Public Limited Company</b> ' (e.g. Reliance), else it's an ' <b>Unlisted Public Limited Company</b> ' (e.g. _____ : IPPB)
<b>Min. authorized capital</b>	₹1 lakh	₹5 lakhs (अधिकृत पूंजी). It's the amount of shares the company can issue.
<b>Min. Paid up Capital</b>	₹0	₹0 (देय पूंजी). The amount of money a company has actually received from the selling of shares.
<b>Directors (Min-Max)</b>	2-15	- Min 3 to Max 15. out of them one must be Indian Resident, 1 must be Woman and 1/3 <sup>rd</sup> of the directors must be independent directors. - Independent directors are persons without any pecuniary interest in company, they protect minority shareholders' interests.
<b>Term limit</b>	N/A	Their directors have age limit, term limit.
<b>Corporate Governance Norms</b>	Norms either not applicable or relaxed.	Companies Act requires them ⇒ to hold specific number of annual meetings of board of directors, norms for quorum, mechanism for e-voting, ⇒ have to appoint Company Secretary,



	<b>Private Ltd.</b>	<b>Public Limited Company (Companies Act 2013)</b>
	UPSC- CSE≠CA	⇒ Implement mechanism for protecting whistleblowers And so on...

#### 9.11.4 Company Types: Misc.

<b>Under Companies Act</b>	⇒ <b>One Person Company:</b> special type of private ltd company having only one member. ⇒ <b>Not for Profit Company:</b> e.g. GSTN, NPCi etc. their profit is re-invested in business expansion. They get certain tax benefits. ⇒ <b>Dormant Companies:</b> A) setup to start business in future B) setup to store intellectual property C) not filled annual returns for two consecutive years.
<b>Under LLP Act 2008</b> सीमित देयता भागीदारी अधिनियम	⇒ Limited Liability Partnership (LLP) Company is formed by minimum 2 or more partners. ⇒ Individual partners are shielded from joint liability created by another partner's wrongful business decisions or misconduct. E.g. Vajiram and Ravi IAS Study Centre LLP ⇒ LLP's registration fees, auditing/reporting norms, tax liabilities, winding up process etc. are more flexible than a (public or pvt) ltd. company registered under Companies Act.
<b>Under Indian Partnership Act 1932</b>	⇒ A Partnership firm is formed by minimum 2 or more partners. ⇒ Each partner is liable jointly with all the other partners for losses, wrongful biz. decisions and misconduct.

## 9.12 STATUTORY BODIES UNDER MINISTRY OF CORPORATE AFFAIRS (MCA)

### 9.12.1 Competition Commission of India (भारतीय प्रतिस्पर्धा आयोग)

- ⇒ Competition among companies= consumer gets goods and services at the most competitive / affordable prices.
- ⇒ Therefore, government must prevent cartelization (price fixing or production fixing by Companies), prevent monopoly (single company commanding the production / supply), protect consumers' interests and ensure freedom of trade.
- ⇒ 1970: Monopolies and Restrictive Trade Practices (**MRTP**) Act. Later replaced with Competition Act, 2002- which has a statutory regulator Competition Commission of India (CCI: 1 Chairman + 6 Members)

### 9.12.2 Insolvency and Bankruptcy Board of India (IBBI)

This too is a statutory body under the Ministry of Corporate Affairs (MCA). Read previous handout for more on I&B Code.



Table 2: Statutory Bodies under Companies Act 2013

Features	National Company Law Tribunal (NCLT)	National Financial Reporting Authority (NFRA)	Investor and Education Protection Fund	SFIO (Serious Fraud Investigation Office)
	राष्ट्रीय कम्पनी विधि अधिकरण	राष्ट्रीय वित्तीय प्रतिवेदन प्राधिकरण	निवेशक एवं शिक्षा रक्षण कोष	गंभीर धोखाधड़ी अन्वेषण कार्यालय
Members	Judicial + technical	Chairman + 3 full time + 9 part time. 3 yr/65, 1-time reappointment. selected by Cabinet Secy. (IAS) committee.	Boss: Corp. Affairs Secretary (IAS). Plus, members from RBI, SEBI, financial experts	Civil servants & financial experts
Appeal	NCLAT (Appellate tribunal)	NFRAA (Appellate Authority)	Not applicable	Regular Courts
Cases	Hear the cases related to Companies Act, Board room battles, Merger-Acquisition, Corporate Insolvency & Bankruptcy (I&B)	Sets standards for Auditors & Chartered Accounts (CA), in listed companies and large unlisted companies. If malpractices-> investigate and Debarr them, Powers of civil court.	They use unclaimed money from shares/bonds for financial literacy and awareness	Investigate white-collar (financial) frauds. Powers to search, seize, arrest. Once SFIO gets case, other agencies (like CBI) can't proceed.

### 9.12.3 MCA also associated with:

<b>Chartered Accountants Act 1949</b>	Regulates the CA profession through a Statutory body: Institute of Chartered Accountants of India (ICAI). ICAI also has IPA status under I&B Code.
<b>Company Secretaries Act, 1980</b>	Statutory Body: Institute of Company Secretaries of India (ICSI). Also has IPA status.
<b>Cost and Works Accountants Act, 1959</b>	Statutory Body: Institute of Cost Accountants of India (ICAI). Also has IPA status.
<b>Legislative Responsibilities of MCA</b>	⇒ Companies Act 1956-> 2013. ⇒ Limited Liability Partnership Act ⇒ Partnership Act ⇒ Societies Registration Act, 1860: for registration of literary, scientific and charitable societies.
<b>E-governance initiatives of MCA</b>	⇒ INC-29 online form to registration of new company. ⇒ MCA-21 portal, where companies can file online documents related to Companies Act compliance.



### 9.13 CORPORATE GOVERNANCE (कॉर्पोरेट शासन)

It is a way of directing the company to protect the interest of all stakeholders, and ensure three types of compliance:

Compliance	Example(s)
<b>Legal-Regulatory</b>	⇒ Company obtaining Legal Entity Identifier (LEI) number as mandated by RBI. ⇒ Company setting up 'Internal Complaints Committee' as mandated by Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 / "POSH Act"
<b>Technical</b>	- Companies keeping balance sheets as per the Ind-AS accounting standards. - Automobile company producing car engines as per BHARAT-Stage emission norms.
<b>Moral-Ethical</b>	Gillette scrapping the ad-contract with cricketer Hardik Pandya for his sexist comments against women on Koffee with Karan Show.

- ⇒ Absence of Corporate Governance leads to fraud, embezzlement (ग़बन), erosion of investors' confidence. E.g. Satyam Computer Scandal (Chairman Ramalinga Raju manipulated account books), Boardroom battles at Tata Group (Cyrus Mistry vs Ratan Tata) and Infosys Group (Narayana Murthy vs Vishal Sikka), ICICI (Boss Chanda Kochhar gave ₹3000 crore loan to Videocon company without due-diligence, which turned NPA.)
- ⇒ Therefore, Companies Act 2013 mandates companies to impose term limits on directors, appoint independent directors, one person can't become director in more than "X" number of companies, one CA can't audit more than "Y" number of companies, companies have to setup whistleblower protection mechanism, Company can't give loan to its directors and so forth.
- ⇒ Notable Committees for improving corporate governance in India: Kumar Mangalam Birla (1999), Narayana Murthy (2003), Adi Godrej (2012), Uday Kotak (2017).
- ⇒ Further, SEBI too can issue directives to Public Limited Companies in the interest of investors, beyond what is required in Companies Act. Such as...

SEBI implemented Uday Kotak committee's suggestions	From 2019-Apr	From 2020-Apr
Split CEO/MD and Chairman. One person can't occupy both positions in his company (e.g. Gautam Adani)	N/A	Top 500 listed cos.
Companies Act requires min.3 directors in Public Listed company, but SEBI mandated to have min. 6 directors	Top-1000 listed cos	Top-2000 listed cos
Companies Act doesn't prescribe gender of independent director but SEBI mandated atleast <b>one independent woman</b> director.	Top 500 listed cos.	Top 1,000 listed cos.
one person can serve as director in how many companies? (Companies Act: Max.10), but SEBI required	8	7

SEBI also tightened norms related to salaries to directors, 'related party transactions' (meaning not important but the fact that term associated with corporate governance / companies act).





### 9.13.1 Corporate Social Responsibility (कॉर्पोरेट सामाजिक जिम्मेदारी)

- ⇒ Mandated under Companies Act 2013: Last 3 years' avg. profit=> spend 2% of that on CSR (education, environment, public health, sanitation, disaster management etc.)
- ⇒ Applicable on both public ltd and private ltd. with very huge profit / turnover / networth (*what's the difference between these terms, what's the exact figure? Ans. UPSC is not Chartered Account exam.*)
- ⇒ Ministry of Corporate Affairs (MCA) gives National CSR Awards to companies.

## 9.14 MOCK QUESTIONS FOR MAINS (GSM3/250 WORDS EACH)

1. "Just as good governance is necessary for vibrant Indian democracy, corporate governance is necessary for vibrant Indian economy." elaborate. "जिस प्रकार जीवंत भारतीय लोकतंत्र के लिए सुशासन आवश्यक है, उसी प्रकार जीवंत भारतीय अर्थव्यवस्था के लिए कॉर्पोरेट शासन आवश्यक है।" विस्तृत कीजिए।
2. Discuss the significance of deepening the capital market to resolve the Twin Balance sheet Syndrome (TBS) in Indian Economy. भारतीय अर्थव्यवस्था में दोहरे तुलन पत्र की चुनौती को हल करने के लिए पूंजी बाजार को गहरा करने के महत्व पर चर्चा करें।
3. Why are Indian financial regulators apprehensive about (1) P-Notes (2) Cryptocurrencies? भारतीय वित्तीय नियामक (1) पी-नोट्स (2) क्रिप्टोकॉइन्स के बारे में आशंकित क्यों हैं?
4. Craze for gold in Indians have led to a surge in import of gold in recent years and put pressure on balance of payments and external value of rupee. In view of this, examine the merits of Sovereign Gold Bond Scheme and Inflation Indexed Bonds (IIB). भारतीयों में सोने के लिए सनक के चलते हाल के वर्षों में सोने के आयात में वृद्धि और भुगतान के संतुलन और रुपये के बाहरी मूल्य पर दबाव बढ़ा है। इसे देखते हुए, संप्रभु स्वर्ण बॉन्ड स्कीम और मुद्रास्फीति सूचकांकित बांड की खूबियों की जांच करें। संतुलन और रुपये के बाहरी मूल्य पर दबाव डाला है। इसे देखते हुए, संप्रभु स्वर्ण बॉन्ड स्कीम और मुद्रास्फीति सूचकांकित बांड की खूबियों की जांच करें।