21

ODDS & EVENS

21.1 Introduction

In addition to the specific segments dealt with in this book, there are a few other important concepts in the capital market which may not necessitate a chapter to themselves but nevertheless are significant enough to merit attention. This Chapter looks at a few such concepts, structures, instruments, etc., which any one dealing with capital markets should be aware of.

21.2 Stock Splits

Stock splits have become extremely popular in India over the last 3-4 years. Today one finds several companies whose paid-up value of their share is not limited to Rs. 10 per share as it used to be in the past. It could be Re.1, Rs. 2, Rs. 4, Rs. 5, etc. This reduced paid-up value in existing companies has been possible by way of a stock split. A stock split as the name suggests is the splitting of a share. It is an increase in the number of issued shares of a company without any corresponding change in the shareholders' equity or the market value of the company or the market capitalisation at the time of the split. However, it may so happen that post-split, the share price may increase or decrease in a manner which is not proportionate to the split. E.g., A Ltd.'s shares of Rs. 10 each are quoting at Rs. 50. It splits its shares to Rs. 2 each. Hence, the market price of the shares should now be Rs. 10. However, it may so happen that post-split the price may be Rs. 12 per share. Thus, the price is not moving in tandem with the split-ratio of 1:5. A company normally resorts to a stock split to improve the liquidity of the its shares and thereby reduce volatility. Usually when a company's share becomes too high priced it acts as a barrier to increased retail participation. This impediment can be overcome by a split. The SEBI DIP Guidelines permit an unlisted company to split its face value. However, it cannot be a decimal of a rupee, e.g., Re. 0.50 and the following additional conditions apply:

- if the issue price is Rs. 500 or more then the Company may fix the face Value below Rs. 10 per share but not lower than Re. 1 per share;

- if the issue price is less than Rs. 500 then the Company must have a face Value of Rs. 10 per share.

Existing companies can freely vary the face value of their shares without any conditions. The company would need to pass a shareholders' resolution to approve of the stock split.

21.3 Minimum Non-promoter Holding

Under Cl.40A of the Listing Agreement, listed companies were required to maintain their public shareholding at a level that was required at the time of initial listing. The minimum public shareholding requirement, therefore, varied in accordance with the provisions applicable at the time of initial listing of the company. This gave rise to a lot of ambiguity and confusion. SEBI has therefore, recently amended the provisions related to minimum public shareholding as follows:

(a) All listed companies will now be required to maintain at least 25% public shareholding for the purpose of continuous listing. Public shareholding has been defined to exclude shares held by promoters/ promoters' group and shares held by the custodian against which ADR/GDRs are issued.

(b) This requirement will not, however, be applicable to companies which was permitted to make an IPO of at least 10% to public in terms of Rule 19(2)(b) of Securities Contracts (Regulation) Rules, 1957 (SCRR). Such companies will be required to maintain at least 10% public shareholding for the purpose of continuous listing. Currently, Rule 19(2)(b) permits a 10% IPO if the following conditions are fulfilled:
  - A minimum of 20 lakhs securities are offered to the public;
  - The size of the offer to the public = Offer Price * number of securities offered to the public = Rs. 100 crores; and
  - The issue was made only through the book building method with at least 60% being offered to Qualified Institutional Buyers.

(c) Companies which have a market capitalisation in of Rs. 1,000 crores or more and the number of listed shares issued by it is 2 crores or more, then will only be required to maintain 10% public shareholding for the purpose of continuous listing.

(d) Listed companies, which are not complying with the minimum public holding requirement as mentioned above as on 1st May, 2006, must increase the public shareholding within such time as is permitted by the Stock Exchange where it is listed. Such time cannot extend beyond 3oth April, 2008. The exchange may however, for certain extraneous reasons, extend the time by another 1 year.

(e) Listed companies must not dilute the public shareholding or allot shares to the promoter group or buyback shares or sponsor an ADR/GDR programme, if such steps reduce the public shareholding. However, if the public

shareholding reduces on account of supervening extraordinary events such as:

(a) issuance or transfer of shares in compliance with directions of a regulatory or statutory authority or court or tribunal;
(b) issuance or transfer of shares in compliance with the Takeover Regulations
(c) re-organization of capital by way of a scheme of arrangement; and
(d) issuance or transfer of shares under a restructuring plan approved in compliance with the Corporate Debt Restructuring System laid down by the RBI then the exchange may extend the time for compliance by two years.

(f) The aforesaid minimum public shareholding requirement is not applicable to Government companies, infrastructure companies and companies registered for rehabilitation with the Board for Industrial Financial Restructuring (BIFR)/ National Company Law Tribunal.
(g) If the Company needs to shore up the public holding, then it has the following methods:
   - issuance of shares to public through prospectus;
   - offer for sale of shares held by promoters to public through prospectus;
   - sale of shares held by promoters through the secondary market; or
   - any other method which does not adversely affect the interest of minority shareholders.
(h) The penalty for non-compliance with this Clause is that the shares of the company are liable to be delisted along with penal action.

21.4 Listing Agreement

All listed companies are required to execute a Listing Agreement with the stock exchanges on which their shares are listed. The clauses for the model Listing Agreement are prescribed from time to time by the SEBI. According to the Securities Contracts (Regulation) Act, where the securities of a company are listed on any Exchange, then it shall comply with the conditions of the Listing Agreement of that Exchange. Thus, it is a precondition for listing. The penalty for non-compliance with the provisions of the Listing Agreement is provided under s.23 of the Securities Contract (Regulation) Act which is an imprisonment term of up to 10 years and/ or a fine of up to Rs. 25 crores.

Some of the important issues which are dealt with in the Listing Agreement are as under:

(a) Time period within and manner in which various information on corporate actions or decisions should be communicated to the Stock Exchanges;

(b) Provisions relating to transfer of shares and securities;

(c) Payment of Listing Fees;

(d) Prior information and approval of the Stock Exchange in the case of corporate reorganisations or arrangements and the contents of the Notice to be circulated to the shareholders;

(e) Condition for maintaining continuous non-promoter holding, i.e., public shareholding at a certain level;

(f) Prior approval of the Exchange before the listing of any securities;

(g) Information to be provided in the Accounts and Quarterly Results of Companies;

(h) Limited Review Report to be submitted by the Auditors on the unaudited Quarterly Results and the format of the Report;

(i) Manner and time of utilisation of the proceeds of a public issue;

(j) Certain procedural provisions such as appointment of a Compliance Officer, audit of Share Transfer Agents;

(k) Clause 49 which is the most important Clause of the Listing Agreement provides for Corporate Governance requirements for listed companies. This Clause has undergone several amendments and improvements from time to time. It was initially conceived based on the recommendations of the Kumar Mangalam Committee on Corporate Governance. The revised Clause 49 based on the recommendations of the Narayan Murthy Committee, which has drastically modified Clause 49 and incorporates several stringent corporate governance measures will now be applicable with effect from 1st January, 2006.

21.5 Insider Trading

21.5.1 Insider Trading was a concept which, till a few years ago, was practically unheard of in the Indian markets although it was practiced in substance. However, the securities scam of 1992 led to the introduction of Insider Trading Regulations. The SEBI (Insider Trading) Regulations, 1992 which deal with insider trading have been substantially amended in 2002 and now have enough teeth to curb insider trading. The amended Regulations incorporate several disclosure and other requirements, the onus of which is cast not only on the Company and its Directors/ Employees but interestingly also on other intermediaries associated with the Company such as Investment bankers, CAs, Lawyers, Auditors, Brokers, etc. The definitions of the terms Insider, Unpublished price sensitive information and Dealing in securities which form the crux of the Regulations are given hereinafter.

21.5.2 The Regulations prohibit any Insider from:

(a) dealing in securities of any listed company, either on his own behalf or on someone else's behalf, when he is in possession of any unpublished price sensitive information;

(b) communicating, counseling or procuring, directly or indirectly, any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities
However, the above shall not apply to any communication required in the ordinary course of business/ profession/ employment or if required under any law.

21.5.3 A company shall not deal in the securities of another company or its associate while in possession of any unpublished price sensitive information. However, in the following cases the company may enter into transactions in listed securities, when its officer/ employee was in possession of unpublished price sensitive information:

(a) if the decision to enter into the transaction was taken by a person other than the officer/employee in possession of such information; and
(b) if the company has such systems and procedures which demarcate the activities of the company in such a way that the person who enters into the transaction on behalf of the company cannot have access to the information which another employee possesses; and
(c) if it had arrangements, in operation, which could reasonable be expected to ensure that information was not communicated to the person who took the decision and that no advice with respect to the transaction was given to that person by that officer/ employee; and
(d) the information was not so communicated and no such advice was given.

Alternatively, if the company can prove that the acquisition of shares was as per the SEBI Takeover Regulations, then it would not be treated as an insider trading.

21.5.4 Any person who violates the above shall be guilty of insider trading.
21.5.5 The Regulations define the term "insider" to mean:
Any person who is or was connected with the company or is deemed to have been connected with the company and who is reasonably expected to have access, to unpublished price sensitive information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information.
The term "connected person" used in the definition of an insider means any person who:

(i) is a director, as defined in s.2(13) of the Companies Act, 1956 of a company, or is deemed to be director of that company by virtue of s.307(10) of the Companies Act or ;
(ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship (which may be temporary or permanent) between himself and the company and who may

reasonably be expected to have an access to unpublished price sensitive information in relation to that company.

A connected person has been defined to mean a person who is a connected person six months prior to the act of insider trading. In addition to the aforesaid general definition, certain persons are deemed to be connected persons.

21.5.6 Price-Sensitive Information which is the most important definition in the Regulations has been defined to mean any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company. It is important to note that not all information is price-sensitive, it is only that information which materially affects the price of the securities of the company which is relevant. What is material is a question of fact and needs to be examined in each case. In addition, certain information is deemed to be price-sensitive information.

21.5.7 The Regulations prescribe a Model Code of Conduct for all listed companies. All Listed Companies must frame a Code of Internal Procedures and Conduct to Prevent Insider Trading. This Code must be on the lines of the Model Code specified by the Regulations.

21.5.8 In addition to the listed entities, all organisations associated with securities markets ("Entities") are also required to frame a Code of Internal Procedures and Conduct to Prevent Insider Trading in Listed Companies. This Code must be on the lines of the Model Code specified by the Regulations. The following organisations associated with securities markets have been expressly specified as requiring a Code of Conduct:

(a) Stock Brokers, Sub-Brokers, Transfer Agents, Investment Bankers, Registrars, Bankers to a Public Issue, Investment Adviser, Portfolio Managers, Asset Management Companies, Trustees of Mutual Funds.

(b) Professional firms such as Auditors, Accountancy Firms, Law Firms, Analysts, Consultants, etc., assisting or advising listed companies.

All the above entities must frame a Code of Conduct, irrespective of whether or not they are privy to confidential/ price-sensitive information.

21.5.9 In addition to the above requirements, certain specified shareholders, Directors, Managers, Secretaries, Auditors, etc., have to comply with initial/ one-time and ongoing/ continuing disclosure requirements.

21.6 Unfair Trade Practices

A Regulation which has gained a lot of prominence in recent times is the SEBI(Prohibition of Fraudulent and Unfair Trade Practices relating to Securities

Market)Regulations, 2003, popularly known as the FUTP Regulations. These Regulations prohibit fraudulent, manipulative and unfair trade practices in dealings in securities. The penalty for violation of the FUTP Regulations, may, in addition to a monetary penalty, also include a ban on accessing the capital markets or dealing in securities. It may be noted that a majority of the Appeals preferred before the Securities Appellate Tribunal against the Orders of the SEBI relate to Orders under the FUTP Regulations.

21.7 Stock Lending Scheme

One of the important and often-overlooked Scheme is the Securities/ Stock Lending Scheme. Often owners of shares lend their shares to other people who utilise the borrowed securities for trading on the exchange, meeting certain requirements, etc. According to the Stock Lending Scheme, the transaction of lending and borrowing of securities must only be carried out through a SEBI-recognised intermediary appointed for this purpose and in compliance with the terms and conditions of the Scheme. SEBI has approved certain intermediaries such as the Stock Holding Corporation of India for this purpose. The key features of this Scheme are as under:

- The lending must be through an approved intermediary only, under an agreement, for a specified period.
- The borrower must undertake to return equivalent securities of the same type or same class along with all benefits.
- There is no direct agreement between the borrower and the lender.
- The lender can only give securities registered in his name or in name of any other person duly authorised on his behalf.
- The title of the securities shall vest with the borrower and the borrower shall be entitled to deal with or dispose off the securities borrowed in any manner.
- The borrower shall not be entitled to discharge his liabilities of returning the securities through payment in cash or kind.
- The beneficial interest in the securities remains with the lender.

21.8 Regulations for Intermediaries

21.8.1 Under the SEBI Act, the SEBI has been empowered to issue various Rules and Regulations to govern and regulate the various intermediaries associated with the Capital Market. The intermediaries for which SEBI has separate Rules and Regulations are as follows:

(a) Stock Brokers and Sub-Brokers
(b) Merchant Bankers
(c) Portfolio Managers
(d) Registrars to an Issue and Share Transfer Agents
(e) Underwriters
(f) Debenture Trustees

(g) Bankers to an Issue
(h) Foreign Institutional Investors
(i) Custodian of Securities
(j) Venture Capital Companies and Venture Capital Funds
(k) Mutual Funds
(l) Credit Rating Agencies
(m) Collective Investment Schemes
(n) Foreign Venture Capital Investors
(o) Depositories and Depositary Participants
(p) Ombudsman
(q) Central Listing Authority.

21.8.2 Most of these Regulations provide for all or at least most of the following issues:
(a) Registration requirements and procedural formalities
(b) Minimum capitalization/ net worth requirements
(c) Requirements for renewal of registration
(d) Books of accounts, documents, Agreements, etc. to be maintained
(e) Appointment of Compliance Officer
(f) Provisions for inspection by the SEBI and furnishing of regular/ periodic and special information by the intermediary to the SEBI.
(g) General obligations and duties of the intermediary
(h) A Model Code of Conduct
(i) Penalties and action to be taken by the SEBI in case of any defaults
(j) One-time and Recurring fees to be paid to the SEBI. In many cases these fees are dependant upon the capitalisation of the entity.

In addition to the above issues, many Regulations such as those dealing with FIIs, Mutual Funds, Venture Capital Funds, Collective Investment Schemes, etc. also provide for investment restrictions, i.e., avenues for investment permitted and prohibited for them along with limits, if applicable.

21.8.3 These Regulations are extremely important for the functioning of the various intermediaries associated with the securities market and it is through these Rules and Regulations that the SEBI maintains a tight watch over them as well as imposes penalties for any violations.

21.9 Informal Guidance Scheme

SEBI has launched the SEBI(Informal Guidance) Scheme, 2003 which is somewhat similar to an Advance Ruling. However, it also has certain fundamental differences as compared to an Advance Ruling. A market intermediary, a listed company, an acquirer/ proposed acquirer under the Takeover Regulations, etc., can make an

application to the SEBI in the prescribed manner for an informal guidance. It may be noted that a CA/ Lawyer cannot make an application for and on behalf of his clients. SEBI may or may not respond to the application. It would respond to the application within a maximum of 60 days and may even grant a hearing to the applicant. If so desired, SEBI would keep the guidance given by it confidential for a specified period which would not exceed 90 days. The most important feature of the guidance is that it is not binding on the SEBI although, it may generally act in accordance with the same. Further, it cannot be construed as a conclusive decision or determination of any question of law or fact by the SEBI and it is not appealable before the Securities Appellate Tribunal.

21.10 Demat of shares

A depository holds securities of investors in electronic form at the request of the investors through a registered Depository Participant. It also provides services related to transactions in securities. Currently, two Depositories, National Securities Depository Limited (NSDL) and Central Depository Services (I) Limited (CDSL) are registered with SEBI. A Depository Participant (DP) is an agent of the depository through which it interfaces with the investor. A DP must be registered with the SEBI. Banking services can be availed through a branch whereas depository services can be availed through a DP. As per the available statistics at BSE and NSE, 99.9% settlement takes place in demat mode only. Therefore, in view of the convenience in settlement through demat mode, it is advisable to have a demat account. The benefits of demat are:

- It is a convenient way to hold securities
- Immediate transfer of securities
- Stamp duty is exempt on transfer of securities;
- No risks associated with physical certificates, e.g., bad delivery, fake securities, delays, thefts etc.
- Lower transaction costs
- Automatic credit of corporate benefits(bonus/ stock splits), shares arising out of merger, demerger, etc.

The demat account must be opened in the same ownership pattern in which the securities are held in the physical form. e. g. if one share certificate is in the individual name and another certificate is jointly with somebody, two different accounts would have to be opened. Dematerialisation is the process by which physical certificates of an investor are converted to an equivalent number of securities in electronic form and credited into the investor's account with his/her DP. Dematerialised shares do not have any distinctive numbers. These shares are fungible, which means that all the holdings of a particular security will be identical and interchangeable. One can even pledge dematerialised securities.

21.11 Securities Premium

Whenever securities are issued at a price above their face value, the excess represents premium. If a company issues shares in its IPO/ FPO at, say, Rs. 100 and the face value of the shares is Rs. 10, then Rs. 90 represents share premium. S.78 of the Companies Act provides that all such premium must be transferred to a Securities Premium Account. This account would be treated as if it were the share capital of the company and all provisions applicable to the capital, including reduction would apply. The uses of this account are as follows:

(a) For paying-up unissued shares of the company to be issued to members as fully paid bonus shares;
(b) For writing off the preliminary expenses;
(c) For writing off the expenses/ commission/ discount on issue of shares or debentures;
(d) For redeeming premium on redemption of preference shares.

Several companies are using the securities premium account to write-off their debit balance in the profit and loss account, miscellaneous expenditure, deferred revenue expenditure, etc, by way of a court-approved process.

21.12 Shares at a discount

The converse of issuing shares at a premium would be to issue them at a discount. Thus, in this case the shares would be issued at a discount to its normal face value. S.79 of the Companies Act, permits a company to issue shares at a discount subject to certain conditions. This section applies to both public and private companies and equity and preference shares. A company can issue shares at a discount if it fulfils the following conditions:

(a) The issue must be authorised by a shareholders' resolution.
(b) It must be authorised by the Company Law Board
(c) The shares are of a class already issued
(d) The maximum rate of discount must be specified in the resolution
(e) The maximum rate allowed by the CLB would be 10% unless it is of the opinion that there are special circumstances which justify a higher percentage
(f) At least one year should have elapsed since the date on which the company became entitled to commence its business
(g) The issue must be made within 2 months of the CLB's sanction or any extended time.

Once the Companies Second Amendment Act of 2002 becomes effective the approval of the Company Law Board will be substituted with that of the Central Government.

An issue of sweat equity shares to employees and directors, which may be at a discount, does not attract the provisions of s.79 specified herein.