Lesson Objectives

- To understand the role of intermediaries in the issue management activity and
- SEBI norms for intermediaries in relation to issue management activities.

Introduction

The new issue market / activity was regulated by the Controller of Capital Issues (CCI) under the provisions of the Capital Issues (Control) Act, 1947 and the exemption orders and rules made under it. With the repeal of the Act and the consequent abolition of the office of the CCI in 1992, the protection of the interest of the investors in securities market and promotion of the development and regulation of the market/ activity became the responsibility of the SEBI. To tone up the operations of the new issues in the country, it has put in place rigorous measures. These cover both the major intermediaries as well as the activities.

So, we will discuss here, various intermediaries, their regulation and SEBI guidelines related to them.

Merchant Bankers

In modern times, importance of merchant banker is very much, because it is the key intermediary between the company and issue of capital. Main activities of the merchant bankers are - determining the composition of the capital structure, drafting of prospectus and application forms, compliance with procedural formalities, appointment of registrars to deal with the share application and transfer, listing of securities, arrangement of underwriting / sub-underwriting, placing of issues, selection of brokers, bankers to the issue, publicity and advertising agents, printers and so on.

Due to overwhelming importance of merchant banker, it is now mandatory that merchant banker(s) functioning as lead manager(s) should manage all public issues. In case of rights issue not exceeding Rs.50 lakh, such appointments may not be necessary. The salient features of the SEBI framework, related to merchant bankers are discussed as under.

Registration : Merchant bankers require compulsory registration with the SEBI to carry out their activities. Previously there were four categories of merchant bankers, depending upon the activities. Now, since Dec. 1997, there is only one category of registered merchant banker and they perform all activities.

Grant of Certificate : The SEBI grants a certificate of registration to applicant if it fulfills all the conditions like (i) it is a body corporate and is not a NBFDC (ii) it has got necessary infrastructure to support the business activity (iii) it has appointed at least two qualified and experienced (in merchant banking) persons (iv) its registration is in the general interest of investors.

Capital Adequacy Requirement : A merchant banker must have adequate capital to support its business. Hence SEBI grants recognition to only those merchant bankers who have paid up capital and free reserves of minimum Rs. 1 crore.

Fee : A merchant banker has to pay a registration fee of Rs. 5 lakh and renewal fees of Rs. 2.5 lakh every three years from the fourth year from the date of registration.

Code of Conduct : Every merchant banker has to abide by the code of conduct, so as to maintain highest standards of integrity and fairness, quality of services, due diligence and professional judgment in all his dealings with the clients and other people. A merchant banker has always to endeavor to (a) render the best possible advice to the clients regarding clients needs and requirements, and his own professional skill and (b) ensure that all professional dealings are effected in a prompt, efficient and cost effective manner.

Restriction on Business : No merchant banker, other than a bank/ public financial institution is permitted to carry on business other than that in the securities market w.e.f. Dec.1997. However a merchant banker who is registered with RBI as a primary dealer/ satellite dealer may carry on such business as may be permitted by RBI w.e.f. Nov.1999.

Maximum number of lead managers : The maximum number of lead managers is related to the size of the issue. For an issue of size less than Rs. 50 crores, two lead managers are appointed. For size groups of 50 to 100 crores and 100 to 200 crores, the maximum permissible lead managers are three and four respectively. A company can appoint five and five or more (as approved by SEBI) lead managers in case of issue sizes between Rs.200 to 400 crores and above Rs.400 crores respectively.

Responsibilities of Lead Managers : Every lead manager has to enter into an agreement with the issuing companies setting out their mutual rights, liabilities and obligation relating to such issues and in particular to disclosure, allotment and refund. A statement specifying these is to be furnished to the SEBI at least one month before the opening of the issue for subscription. It is necessary for a lead manager to accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakh whichever is less.

Due diligence certificate : The lead manager is responsible for the verification of the contents of a prospectus / letter of offer in respect of an issue and the reasonableness of the views expressed in them. He has to submit to the SEBI at least two weeks before the opening of the issue for subscription a due diligence certificate.

Submission of documents : The lead managers to an issue have to submit at least two weeks before the date of filing with the ROC/ regional SE or both, particulars of the issue, draft prospectus/ letter of offer, other literature to be circulated to the investors / shareholders, and so on to the SEBI. They have to ensure that the modifications/ suggestions made by it with
respect to the information to be given to the investors are duly incorporated.

Acquisition of Shares: A merchant banker is prohibited from acquiring securities of any company on the basis of unpublished price sensitive information obtained during the course of any professional assignment either from the client or otherwise.

Disclosure to SEBI: As and when required, a merchant banker has to disclose to SEBI (i) his responsibilities with regard to the management of the issue, (ii) any change in the information/ particulars previously furnished which have a bearing on the certificate of registration granted to it, (iii) names of the companies whose issues he has managed or has been associated with (iv) the particulars relating to the breach of capital adequacy requirements and (v) information relating to his activities as manager, underwriter, consultant or advisor to an issue.

Action in case of Default: A merchant banker who fails to comply with any conditions subject to which the certificate of registration has been granted by SEBI and / or contravenes any of the provisions of the SEBI Act, rules or regulations, is liable to any of the two penalties (a) Suspension of registration or (b) Cancellation of registration.

Underwriters

Another important intermediary in the new issue/ primary market is the underwriters to issue of capital who agree to take up securities which are not fully subscribed. They make a commitment to get the issue subscribed either by others or by themselves. Though underwriting is not mandatory after April 1995, its organization is an important element of primary market. Underwriters are appointed by the issuing companies in consultation with the lead managers / merchant bankers to the issues.

Registration: To act as underwriter, a certificate of registration must be obtained from SEBI. On application registration is granted to eligible body corporate with adequate infrastructure to support the business and with net worth not less than Rs. 20 lakhs.

Fee: Underwriters had to pay Rs. 5 lakh as registration fee and Rs. 2 lakh as renewal fee every three years from the fourth year from the date of initial registration. Failure to pay renewal fee leads to cancellation of certificate of registration.

General Obligations and Responsibilities

Code of conduct: Every underwriter has at all times to abide by the code of conduct; he has to maintain a high standard of integrity, dignity and fairness in all his dealings. He must not make any written or oral statement to misrepresent (a) the services that he is capable of performing for the issuer or has rendered to other issues or (b) his underwriting commitment.

Agreement with clients: Every underwriter has to enter into an agreement with the issuing company. The agreement, among others, provides for the period during which the agreement is in force, the amount of underwriting obligations, the period within which the underwriter has to subscribe to the issue after being intimated by/ on behalf of the issuer, the amount of commission/ brokerage, and details of arrangements, if any, made by the underwriter for fulfilling the underwriting obligations.

General responsibilities: An underwriter cannot derive any direct or indirect benefit from underwriting the issue other than by the underwriting commission. The maximum obligation under all underwriting agreements of an underwriter cannot exceed twenty times his net worth. Underwriters have to subscribe for securities under the agreement within 45 days of the receipt of intimation from the issuers.

Bankers to an Issue

The bankers to an issue are engaged in activities such as acceptance of applications along with application money from the investor in respect of capital and refund of application money.

Registration: To carry on activity as a banker to issue, a person must obtain a certificate of registration from the SEBI. The applicant should be a scheduled bank. Every banker to an issue had to pay to the SEBI an annual fee for Rs. 5 lakh and renewal fee or Rs. 2.5 lakh every three years from the fourth year from the date of initial registration. Non-payment of the prescribed fee may lead to the suspension of the registration certificate.

General Obligations and Responsibilities

Furnish Information: When required, a banker to an issue has to furnish to the SEBI the following information: (a) the number of issues for which he was engaged as banker to an issue (b) the number of applications / details of the applications money received (c) the dates on which applications from investors were forwarded to the issuing company / registrar to an issue (d) the dates / amount of refund to the investors.

Books of account/ record / documents: A banker to an issue is required to maintain books of accounts/ records/ documents for a minimum period of three years in respect of, inter alia, the number of applications received, the names of the investors, the time within which the applications received were forwarded to the issuing company / registrar to the issue and dates and amounts of refund money to investors.

Agreement with issuing companies: Every banker to an issue enters into an agreement with the issuing company. The agreement provides for the number of collection centers at which application/ application money received is forwarded to the registrar for issuance and submission of daily statement by the designated controlling branch of the banker stating the number of applications and the amount of money received from the investor.

Code of Conduct: Every banker to an issue has to abide by a code of conduct. He should observe high standards of integrity and fairness in all his dealings with clients / investors/ other members of the profession. He should exercise due diligence. A banker to an issue should always endeavor to render the best possible advice to his clients and ensure that all professional dealings are effected in a prompt, efficient and cost-effective manner.

Brokers to the Issue

Brokers are persons mainly concerned with the procurement of subscription to the issue from the prospective investors. The appointment of brokers is not compulsory and the companies
are free to appoint any number of brokers. The managers to the
issue and the official brokers organize the preliminary distribu-
tion of securities and procure direct subscription from as large
or as wide a circle of investors as possible. A copy of the
consent letter from all the brokers to the issue, should be filed
with the prospectus to the ROC.

The brokerage applicable to all types of public issue of indus-
trial securities is fixed at 1.5%, whether the issue is underwritten
or not. The listed companies are allowed to pay a brokerage on
private placement of capital at a maximum rate of 0.5%.
Brokerage is not allowed in respect of promoters' quota
including the amounts taken up by the directors, their friends
and employees, and in respect of the rights issues taken by or
renounced by the existing shareholders. Brokerage is not
payable when the applications are made by the institutions/
bankers against their underwriting commitments or on the
amounts devolving on them as underwriters consequent to the
under subscription of the issues.

Registrars to an Issue and Share Transfer
Agents

The registrars to an issue, as an intermediary in the primary
market, carry on activities such as collecting applications from
the investors, keeping a proper record of applications and
money received from the investors or paid to the sellers of
securities and assisting companies in determining the basis of
allotment of securities in consultation with the stock exchanges,
finalizing the allotment of securities and processing / dispatch-
ning allotment letters, refund orders, certificates and other related
documents in respect of the issue of capital.

To carry on their business, the registrars must be registered with
the SEBI. They are divided into two categories : (a) Category I,
to carry on the activities as registrar to an issue and share transfer
agent; (b) Category II, to carry on the activity either as registrar
or as a share transfer agent. Category I registrars must have
minimum net worth of Rs. 6 lakhs and Category II, Rs. 3.
Category I is required to pay a initial registration fee of Rs.
50,000 and renewal fee of Rs.40,000 every three years, where as
Category II is required to pay Rs.30,000 and Rs. 25,000 respec-
tively.

Code of Conduct : The registrars to an issue and the share
transfer agents have to maintain high standards of integrity and
fairness in all dealings with their clients and other registrars to
the issue and share transfer agents in the conduct of the
business. They should endeavor to ensure that (a) enquiries
from investors are adequately dealt with, and (b) adequate steps
are taken for proper allotment of securities and refund of
application money without delay and as per law. Also, they
should not generally and particularly in respect of any dealings
in securities to be a party to (a) creation of false market, (b) price
rigging or manipulation (c) passing of unpublished price
sensitive information to brokers, members of stock exchanges
and other intermediaries in the securities market or take any
other action which is not in the interest of the investors and (d)
no registrar to an issue, share transfer agent or any of its
directors, partners or managers managing all the affairs of the
business is either on their respective accounts, or through their
respective accounts, or through their associates or family
members, relatives or friends indulges in any insider trading.

Debenture Trustees

A debenture trustee is a trustee for a trust deed needed for
securing any issue of debentures by a company. To act as a
debenture trustee a certificate from the SEBI is necessary. O nly
scheduled commercial banks, PFIs, Insurance companies and
companies are entitled to act as a debenture trustees. The
certificate of registration is granted to suitable applicants with
adequate infrastructure, qualified manpower and requisite
funds. Registration fee is Rs. 5 lakh and renewal fee is Rs. 2.5
lakh every three years.

Responsibilities and obligations : Before the issue of
debentures for subscription, the consent in writing to the
issuing company to act as a debenture trustee is obligatory. He
has to accept the trust deed which contains matters pertaining to
the different aspects of the debenture issue.

Duties : The main duties of a debenture trustee include the
following :
i. Call for periodical report from the company.
ii. Inspection of books of accounts, records, registration of
the company and the trust property to the extent necessary
for discharging claims.
iii. Take possession of trust property, in accordance with the
provisions of the trust deed.
iv. Enforce security in the interest of the debenture holders.
v. Carry out all the necessary acts for the protection of the
debenture holders and to the needful to resolve their
grievances.
vi. Ensure refund of money in accordance with the Companies
Act and the stock exchange listing agreement.
vii. Exercise due diligence to ascertain the availability of the
assets of the company by way of security as well as their
adequacy / sufficiency to discharge claims when they become
due.
viii. Take appropriate measure to protect the interest of the
debenture holders as soon as any breach of trust deed / law
comes to notice.
ix. Ascertain the conversion / redemption of debentures in
accordance with the provisions / conditions under which
they were offered to the holders.
x. Inform the SEBI immediately of any breach of trust deed /
provisions of law.

In addition, it is also the duty of trustees to call or ask the
company to call a meeting of the debenture holders on a
requisition in writing signed by debenture holders, holding at
least one-tenth of the outstanding amount, or on the happen-
ing of an event which amounts to a default or which, in his
opinion, affects their interest.

Portfolio Managers

Portfolio manager are defined as persons who in pursuance of a
contract with clients, advise, direct, undertake on their behalf the
management/ administration of portfolio of securities/ funds
of clients. The term portfolio means the total holdings of
The portfolio management can be (i) Discretionary or (ii) Non-discretionary. The first type of portfolio management permits the exercise of discretion in regard to investment / management of the portfolio of the securities / funds. In order to carry on portfolio services, a certificate of registration from SEBI is mandatory.

The certificate of registration for portfolio management services is granted to eligible applicants on payment of Rs. 5 lakh as registration fee. Renewal may be granted by SEBI on payment of Rs. 2.5 lakh as renewal fee (every three years).

**Contract with clients:** Every portfolio manager is required, before taking up an assignment of management of portfolio on behalf of the client, to enter into an agreement with such clients clearly defining the inter se relationship, and setting out their mutual rights, liabilities and obligations relating to the management of the portfolio of the client. The contract should, inter alia, contain:

i. The investment objectives and the services to be provided.

ii. Areas of investment and restrictions, if any, imposed by the client with regards to investment in a particular company or industry.

iii. Attendant risks involved in the management of portfolio.

iv. Period of the contract and provisions of early termination, if any.

v. Amount to be invested.

vi. Procedure of setting the clients’ account including the form of repayment on maturity or early termination of contract.

vii. Fee payable to the portfolio managers

viii. Custody of securities.

The funds of all clients must be placed by the portfolio manager in a separate account to be maintained by him in a scheduled commercial bank. He can charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and such fee should be independent of the returns to the client and should not be on a return sharing basis.

**Investment of Clients money:** The portfolio manager should not accept money or securities from his clients for less than one year. Any renewal of portfolio fund on the maturity of the initial period is deemed as a fresh placement for a minimum period of one year. The portfolio funds and be withdrawn or taken back by the portfolio clients at his risk before the maturity date of the contract under the following circumstances:

a. Voluntary or compulsory termination of portfolio management services by the portfolio manager.

b. Suspension or termination of registration of portfolio manager by the SEBI.

c. Bankruptcy or liquidation in case the portfolio manager is a body corporate.

d. Permanent disability, lunacy or insolvency in case the portfolio manager is an individual.

The portfolio manager can invest funds of his clients in money market instruments or as specified in the contract, but not in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies. While dealing with client’s money he should not indulge in speculative transactions.

**Reports to be furnished to the Clients:** The portfolio manager should furnish periodically a report to the client, agreed in the contract, but not exceeding a period of six months containing the following details:

a. The composition and the value of the portfolio, description of security, number of securities, value of each security held in portfolio, cash balances aggregate value of the portfolio as on the date of report.

b. Transactions undertaken during the period of report including the date of transaction and details of purchases and sales.

c. Beneficial interest received during that period in respect of interest, dividend, bonus shares, rights shares and debentures,

d. Expenses incurred in managing the portfolio of the client and details of risk relating to the securities recommended by the portfolio manager for investment or disinvestments.

So, we discussed so far the intermediaries in security market. Next task of yours would be to submit in writing the latest regulations of SEBI in the regards to various intermediaries.