FINAL EXAMINATION

GROUP III

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2012

Paper- 11 : CAPITAL MARKET ANALYSIS & CORPORATE LAW

Time Allowed : 3 Hours **Full Marks :** 100

The figures in the margin on the right side indicate full marks.

Please (1) Answer all bits of a question at one place.
(2) Open a new page for answer to a new question.
(3) Attempt the required number of question only.

SECTION - I (60 Marks)
(Capital Market Analysis)

Answer **Question No. 1** *(carrying 20 marks) which is compulsory and answer* **any two** *(carrying 20 marks each) from the rest in this Section.*

Q. 1. (a) In each of the cases given below, one out of four is correct. Indicate the correct answer (= 1 mark) and give workings/reasons briefly in support of your answer (= 1 mark).

(i) MS BRISTI, a prospective investor has collected the following information pertaining to two securities A and B.

Particulars	Security A	Security B
Expected Return %	15	18
Standard deviation of returns (%)	18	22
Beta	0.90	1.40

The correlation co-efficient between the returns on security A and B is 0.75. If the variance of returns on the market index is 225%, the systematic risk of a portfolio consisting of these two securities in equal proportions will be :

(A) 125.78%

(B) 297.56%

(C) 420.50%

(D) None of the above.

(ii) Consider a bullish spread option strategy using a call option on the stock of ROYAL LTD. with ₹ 60 exercise price, priced at ₹ 6 and a call option with ₹ 75 exercise price, priced at ₹ 3.50. The current market price of stock of Royal Ltd. is ₹ 67. If the price of the stock is ₹ 95 on maturity, the net profit at expiration will be

(A) ₹ 1.50

(B) ₹ 10.50

(C) ₹ 12.50

(D) ₹ 72.50

(iii) The beta of stock of ANKIT Ltd. is 2·00 and is currently in equilibrium. The required return on the stock is 12% and expected return on the market is 10%. Suddenly due to change in the economic conditions, the expected return on the market increases to 12%. Other things remaining the same what would be new required return on the stock?

(A) 15·0%

(B) 16·0%

(C) 20·0%

(D) 22·5%

(iv) The share price of RANA Ltd. (F. V. ₹ 10) quotes ₹ 500 in the NSE and the 3 months future price quotes at ₹ 525. The borrowing rate is 12% p.a. If the expected annual dividend yield is 15% payable before expiry, then the price of 3 months RANA Ltd's future would be

(A) ₹ 500·00

(B) ₹ 513.50

(C) ₹ 516·50

(D) Insufficient information.

(v) The NAV of each unit of a closed-end fund at the beginning of the year was ₹ 18. By the end of the year its NAV equals ₹ 18·50.At the beginning of the year each unit was selling at a 2% Premium to NAV and by the end of the year each unit is selling at a 4% discount to NAV.

If the closed-end fund paid year end distribution of income of ₹ 2·50 on each unit, the rate of return to the investor in the fund during the year would be

(A) 10·35%

(B) 11·51%

(C) 11·95%

(D) None of the above. [2×5=10]

(b) Choose the most appropriate one from the stated options and write it down (only indicate A or B or C or D as you think correct).

(i) Residual analysis is a test of

(A) Weak form of market efficiency

(B) Semi-strong form of market efficiency

(C) Strong form of market efficiency

(D) Super-strong form of market efficiency.

(ii) Arbitrage pricing theory model helps to

(A) Reduce risk

(B) Eliminate arbitrage

(C) Identify the equilibrium asset price

(D) None of the above.

(iii) Which of the following is/are assumption(s) common to both Markowitz model and CAPM?

(A) Investors can borrow and lend at risk free rate

(B) There are no market imperfection

(C) Investors choose portfolios on the basis of their expected mean and variance of returns

(D) None of the above.

(iv) Non-systematic (Non-Market) Risk is attributable to factors unique to

(A) Then Industry

(B) A Security

(C) A Company

(D) Concerned stock exchange.

(v) An investor has received bonus shares from ALBUNO LTD., a listed company, in the ratio of 1 : 2. Afet the receipt of bonus shares :

(A) There is no change in stockholding and it remains the same

(B) There is no change in stockholding, but more shares available for trading

(C) Stockholding has gone up with more shares available for trading

(D) Stockholding has gone up. [1×5=5]

(c) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/number(s).

(i) "Term money" is a form of __________ market instrument.

(ii) Insurance Regulatory and Development Authority (IRDA) Act was passed in the year __________ .

(iii) In an arbitrage portfolio, the change in the proportions of different securities will add upto __________ .

(iv) Chart reading as a comprehensive technique, was developed by __________ .

(v) As per existing SEBI Regulations, the allocation of shares under IPO to QIBs, NIIs and retail investors has to be in the ratio of __________ . [1×5=5]

Answer 1. (a)

(i) (B) 297.56%

The Beta of the portfolio consisting of two securities in the equal proportion :

= 0.90 × 0.50 + 1.40 ×0.50

= 1.15

The systematic risk of a portfolio = $\beta^2\sigma^2m$

We get, $(1.15)^2 \times 225 = 297.56\%$

(ii) (C) ₹ 12.50

Buy a call option with exercise price of ₹ 60 @ ₹ 6.00
Sell a call option with exercise price of ₹ 75 @ ₹ 3.50
Initial outlay ₹ 2.50

If the stock price on expiration increases to 95
Profit from buying call option (95-60) = ₹ 35
Loss on selling call option (95-75) = ₹ 20
₹ 15
Net Pay -off after considering initial outlay : ₹ (15-2.50) = ₹ 12.50

(iii) (B) 16.0%
12 = R_f+2 (10-R_f) or, R_f = Risk free rate = 20-12 = 8%
Revised R (Required return) = 8 + (12-8) × 2 = 16%

(iv) (B) ₹ 513.50
Future Price = Spot price + Cost of Carry – Dividend
= 500 + [500 ×(0.12×3)/12]–10×0.15
= 500 + 15 – 1.50 = ₹ 513.50

(v) (A) 10.35%
The price of unit at the beginning of the year
18 × 1.02 = ₹ 18.36
The price of unit at the end of the year
18.50 × (1–.04) = ₹ 17.76
The price of the fund fell by (17.76 – 18.36) = -0.60
Rate of return = (2.50-0.60) ÷ 18.36 = 10.35%

Answer 1. (b)

(i) — (B) A market has **semi-strong efficiecy** if prices fully reflect all readily-available public information—past prices, economic news, earnings reports, etc. Tests of semi-strong efficiency are those that study stock price movements following announcements, such as stock splits or earnings announcements.

(ii) — (C) **Arbitrage pricing theory (APT)** is a general theory of asset pricing that holds that the expected return of a financial asset can be modeled as a linear function of various macro-economic factors or theoretical market indices, where sensitivity to changes in each factor is represented by a factor-specific beta coefficient.

(iii) — (C) Markowitz model considers a portfolio that gives maximum return for a given risk, or minimum risk for given return as an efficient portfolio. The CAPM assumes that the risk-return profile of a portfolio can be optimized—an optimal portfolio displays the lowest possible level of risk for its level of return.

(iv) — (B) The potential for gains and losses in a portfolio which is not related to the movement of the market in general.

(v) — (B) Bonus shares are additional free shares issued to the shareholder by the company. Profitable Companies in India issue Bunus Shares. These are additional share issues given the shareholder without any cost to existing shareholders.

Answer 1. (c)

(i) Money

(ii) 1999

(iii) ZERO

(iv) Rosenberg

(v) 50 : 15 : 35

Q. 2. (a) Who are the Qualified Institutional Buyers (QIBs) as per SEBI Guidelines for primary issuance process? Is there any need to register with SEBI in this regard? [6]

(b) MR ANIL KOTHARI, an investors is evaluating the prospects of investing in two Companies SNOAKER LTD and GLOBAL LTD. The projections of returns for the stocks of these two Companies along with their probabilities are as follows :

Probability	Returns associated with	
	SNOAKER LTD.	GLOBAL LTD.
0.20	12%	16%
0.25	14%	10%
0.25	– 7%	28%
0.30	28%	– 2%

You are required to :

(i) Comment on the return and risk of investment in individual stocks.

(ii) Compare the risk and return of these two stocks with a portfolio of these stocks in equal proportions.

(iii) Find out the proportions of each of the above two stocks to construct a minimum risk portfolio. [5+5+4=14]

Answer 2. (a)

Qualified Institutional Buyers are those institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital market. As per the SEBI guidelines QIBs shall mean the following :

- Public Financial Institution as defined in section 4A of the Companies Act, 1956.
- Scheduled Commercial Banks.
- Mutual Funds.
- Foreign Institutional Investors registered with SEBI.
- Multilateral and Bilateral Development Financial Institutions.

- Venture Capital Funds registered with SEBI.
- Foreign Venture Capital Investors registered with SEBI.
- State Industrial Development Corporations.
- Insurance Companies registered with the Insurance Regulatory and Development Authority (IRDA).
- Provident Funds with minimum corpus of ₹ 25 crores.
- Pension Funds with minimum corpus of ₹ 25 crores.

These entities are not required to register with SEBI as QIBs. Any entities falling under the categories specified above are considered as QIBs for the purpose of participating in primary issuance process.

Answer 2. (b)

(i) **MR. ANIL KOTHARI**

Probability (1)	**SNOAKER LTD Return (%) (SL) (2)**	**GLOBAL LTD Return (%) (GL) (3)**	**(1×2) (4)**	**(1×3) (5)**
0.20	12	16	2.40	3.20
0.25	14	10	3.50	2.50
0.25	– 7	28	– 1.75	7.00
0.30	28	– 2	8.40	– 0.60
			12.55	12.10

Hence, the expected return of SNOAKER LTD ($\overline{SL}$) = 12.55%

and the expected return of GLOBAL LTD ($\overline{GL}$) = 12.10%

Probability (1)	**$SL - \overline{SL}$ (2)**	**$(SL - \overline{SL})^2$ (3)**	**1 × 3 (4)**	**$GL - \overline{GL}$ (5)**	**$(GL - \overline{GL})^2$ (6)**	**1 × 6 (7)**
0.20	– 0.55	0.3025	0.0605	3.90	15.21	3.042
0.25	1.45	2.1025	0.5256	– 2.10	4.41	1.1025
0.25	– 19.55	382.2025	95.5506	15.90	252.81	63.2025
0.30	15.45	238.7025	71.6107	– 14.10	198.81	59.643
			167.75			126.99

σ^2_{SL} = 167.75% σ_{SL} = 12.95%

σ^2_{GL} = 126.99% σ_{GL} = 11.27%

(ii) In order to find the risk of Portfolio of two stocks, the co-variance between the stocks is necessary. This is calculated as follows :

Probability (1)	**$(SL - \overline{SL})$ (2)**	**$(GL - \overline{GL})$ (3)**	**(2×3) (4)**	**(1×4) (5) Cov (SL GL)**
0.20	– 0.55	3.90	– 2.145	– 0.4290
0.25	1.45	– 2.10	– 3.045	– 0.7613
0.25	– 19.55	15.90	– 310.845	– 77.7112
0.30	15.45	– 14.10	– 217.845	– 65.3535
				– 144.255

σ_p^2 = $(0.5)^2 \times 167.75 + (0.5)^2 \times 126.99 + \{2 \times (-144.255) \times 0.5 \times 0.5\}$

= $41.9375 + 31.7475 - 72.1275 = 1.5575$ $\therefore$ $\sigma_p = 1.25\%$

$E(R_p) = 0.50 \times 12.55 + 0.50 \times 12.10 = 12.325\%$

Hence, the return is 12.325% with risk of 1.25% for the portfolio. Thus the portfolio results in risk reduction by the combination of two risky securities.

(iii) For Constructing a minimum risk Portfolio the condition to be satisfied is :

$$W_{SL} = \frac{\sigma_{GL}^2 - r(SL\ GL)\,\sigma_{SL}\,\sigma_{GL}}{\sigma_{SL}^2 + \sigma_{GL}^2 - 2\,(r\ SL\ GL)\,\sigma_{SL}\,\sigma_{GL}}$$

$$= \frac{\sigma_{GL}^2 - Cov_{SL\,GL}}{\sigma_{SL}^2 + \sigma_{GL}^2 - 2\,Cov_{SL\,GL}}$$

$$\text{Thus \% SL} = \frac{126.99 - (-144.255)}{167.75 + 126.99 - 2x(-144.255)} = \frac{271.245}{583.25} = 0.4651 \sim 46.5\%$$

% GL = 1 – 0.4651 = 0.5349 ~ 53.49%

Hence, the proportion of the two stocks to construct a minimum risk portfolio is :

SNOAKER LTD : 46.51% and GLOBAL LTD : 53.49%

Q. 3. (a) Can it be said that "Derivatives are complex and exotic instruments that Indian investors will have difficulty in understanding"? [6]

(b) The shares of EXECPRO LTD. are currently priced at ₹ 408 and call option exercisable in three months' time has a exercise rate of ₹ 400. Risk free interest rate is 5% p.a. and standard deviation (volatility) of share price is 22%. The Company is going to declare a dividend of ₹ 10 and it is expected to be paid in two months time.

Required :

(i) Determine the value of a three-month CALL OPTION on the share of Execpro Ltd. based on Black Scholes Model.

(ii) What would be the worth of PUT OPTION if the current price is considered to be ₹ 390?

Note : Extracted from the tables :

1. In (0.99521) = – 0.00480, In (1.00481) = 0.004798
2. Value of e^{-x} : $e^{-0.01} = 0.99005$, $e^{-0.0125} = 0.987578$, $e^{-0.008333} = 0.9917$
3. Cumulative standardized normal probability distribution : NCX.

When $X \geq 0$: N (0.125) = 0.5498, N (0.015) = 0.5060

When $X \leq 0$: N (–0.125) = 0.4502, N (–0.015) = 0.4940 [6+2=8]

(c) TEMPLAN MUTUAL FUND has a NAV of ₹ 17.50 at April 1, 2011. At March 31, 2012 NAV of the Fund increases to ₹ 18.90. During the year 2011-2012, Templan Mutual Fund distributes ₹ 1.50 as dividend per unit and ₹ 1.20 per unit as Capital gain.

Required :

(i) What is the fund's return during the year 2011-12?

(ii) Assuming that Ms ANURADHA, an investor had 300 units and also assuming that the distribution of all dividends and capital gains have been re-invested at an average NAV of ₹ 17.30, what is the return? [2+(2+2)=6]

Answer 3. (a)

Trading in standard derivatives such as forwards, futures and options is already prevalent in India and has a long history. Reserve Bank of India allows forward trading in Rupee-Dollar forward contracts, which has become a liquid market. RBI also allows Cross-Currency options trading.

Forward Market Commission has allowed trading in Commodity Forwards on Commodities Exchanges which are Called Futures in International markets. Commodities futures in India are available in turmeric, black pepper, coffee, Gur (jaggery) hessian, Castor seed oil etc. There are plans to set up commodities futures exchanges in soyabean oil as also in cotton. International markets have also been allowed (dollar denominated contracts) in certain commodities. RBI also allows the users to hedge their portfolios through derivatives exchanges abroad.

Derivatives in Commodities markets have a long history. The first commodity futures exchange was set up in 1875 in Mumbai under the aegis of Mumbai Cotton Traders Association (Dr. A. S. Naik 1968, Chairman, Forward Market Commission, India 1963-68).

History and existence of markets along with setting up of new markets prove that the concept of Derivatives is not alien in India. In commodity markets there is no resistance from the users or market participants to trade in commodity futures or foreign exchange markets. Government of India has also been facilitating the setting up and operations of these markets in India by providing approvals and defining appropriate regulatory frameworks for their operations.

This amply proves that the Concept of options and futures has been well ingrained in the Indian equities market for a longtime and is not alien as it is made out to be. Even to-day complex strategies of options are being traded in many exchanges which are called teji-mandi, Jotaphatak, bhav-bhav at different places in India (vohra and Bagari 1998). In that sense, the derivatives are not new to India and are also currently prevalent in various markets including equities markets.

Answer 3. (b)

EXECPRO LTD

(i) Since dividend is expected to be paid in two months time we have to adjust the share price and then use BLACK SCHOLES MODEL to value the option :

Present Value of Dividend (using continuous discounting)

= Dividend × e^{-rt} = 10 × $e^{-0.05 \times 0.1666}$

= ₹ 10 × $e^{-0.008333}$

= ₹ 9.917

Adjusted price of shares is ₹ 408 – ₹ 9.917 = ₹ 398.083

This can be used in Block Scholes model

$$d_1 = \frac{l_n\left(\frac{398.083}{400}\right) + \left[0\cdot 05 + \frac{1}{2}(0\cdot 22)^2\right]0\cdot 25}{0\cdot 22\sqrt{0\cdot 25}}$$

$$= \frac{-0\cdot 00480 + 0\cdot 01855}{0\cdot 11}$$

$= 0.125$

$$d_2 = \frac{l_n\left(\frac{398.083}{400}\right) + \left[\cdot 05 - \frac{1}{2}(0\cdot 22)^2\right]0\cdot 25}{0\cdot 22\sqrt{0\cdot 25}}$$

$$= \frac{-0\cdot 00480 + \cdot 00645}{0\cdot 11}$$

$= 0.015$

$N(d_1) = N(.125) = 0.5498$

$N(d_2) = N(.015) = 0.5060$

Value of Call Option : Vs 1 = $N(d_1) - E.e^{-rt} N(d_2)$.

Vc = Value of Option = 398.083 (0.5498) – 400 × $e^{-0.05\times 0.25}$ × 0.5060

= 218.866 – 400 × 0.987578 × 0.5060

= 218.866 – 395.03 × 0.5060

= 218.866 – 199.8858 = ₹ 18.9802 ~ 18.98

= ₹ 18.98

(ii) Value of PUT OPTION : Vp = – Vs + Vc + Pv (E)

Vp = – 390 + 18.98 + 0.987654 × 400

= – 390 + 18.98 + 395.06 = ₹ 24.04

= ₹ 24.04.

Answer 3. (c)

<u>TEMPLAN MUTUAL FUND</u>

(i) Returns for the year - 2011-12 :

(All Changes on a per-unit Basis)

Changes in price : (₹ 18.90 – ₹ 17.50)		= ₹ 1.40
Dividends received :	₹ 1.50	
Capital gains distribution :	₹ 1.20	₹ 2.70
Total reward		₹ 4.10

Holding period reward : $\frac{4.10}{17.50} \times 100$ = 23.43%.

(ii) When all dividends and Capital gains distributions are re-invested into additional units of the fund @ (₹ 17.30/unit)

Dividends and capital Gains per unit :	₹ 2.70
Total received from 300 units (2.70×300)	₹ 810.00
Additional Units Acquired : (810 ÷ 17.30)	= 46.82 units
Total Number of units : (300 + 46.82)	= 346.82 units

Value of 346.82 units held at the end of year 2011-12.

$346.82 \times 18.90 = ₹\ 6554.90$

Price paid for 300 units at the beginning of the year 2011-12

$= (300 \times 17.50) = ₹\ 5250.00.$

Thus the holding period reward (Return) would be :

$$\frac{6554.90 - 5250.00}{5250} \times 100 = \frac{₹1304.90}{₹5250.00} \times 100$$

$$= 24.8552\% \sim 24.85\%$$

Q. 4. (a) PROTECT LTD. pays no taxes and is entirely financed by equity shares. The equity share has a beta of 0.60 and price earning ratio of 5 and is priced to offer an expected return of 20%.

Protect Ltd, now decides to buy-back half of the equity shares by borrowing an equal amount. The debt yields a Risk-free return of 10%.

You are required to calculate

(i) The beta of the equity shares after the buy-back

(ii) The required return and risk premium on the equity shares before and after the buy-back

(iii) The required return on debt

(iv) The percentage increase in expected earnings per share

(v) The new price earnings multiple

Assume that the operating profit of the company is expected to remain constant in perpetuity.

[2+6+4=12]

(b) Describe the grounds on which an Ombudsman can reject complaints lodged with him, under the Banking Ombudsman Scheme, 2006. Can an appeal be filed against such a rejection, and if so, to whom and within what time limit? [4]

(c) The following quotes were observed by MR KARUNA on March 10, 2012 in the Economic Times :

(i) SBI MARCH 2012 FUT 1441

(ii) NIFTY APRIL 2012 FUT 4280.

Required :

(i) Explain what these quotes indicate?

(ii) If the initial Margin is 10% and Mr. Karuna wants to buy 100 of each how much margin he has to deposit individually? [2+2=4]

Answer 4. (a)

PROTECT LTD.

(i) Beta of equity shares after buy-back :

Before buy-back Protect Ltd. is all equity financed and the equity beta is 0.60.

Expected return on Equity is 20%

Thus, the Company's beta is 0.6 and the Cost of Capital is 20%.

The Company value will not change after the buy-back and the debt is risk free.

$$\text{Beta}_A = \frac{D}{D+E}(\text{Beta}_D) + \frac{E}{D+E}(\text{Beta}_E)$$

$0.6 = 0.5 \times 0 + 0.5 \times \text{Beta}_E$ or, $\text{Beta}_E = 0.6 \div 0.5 = 1.20$

(ii) Required return and Risk Premium :

Particulars	**Before Buy-back**	**After buy-back**
Return on Equity	20% (given)	$R_A = \frac{D}{D+E}(R_D) + \frac{E}{D+E} \times R_E$ $0.20 = 0.5 \times 0.10 + 0.5 \times R_E$ $0.20 = 0.05 + 0.5\ R_E$ $R_E = (0.20 - 0.05) \div 0.5$ $= 30\%$
Risk-free Rate	10%	10%
Risk Premium	$R_A = R_F + (R_M - R_F) \times \beta$ $20\% = 10 + (R_M - 10) \times 0.6$ $10 = (R_M - 10) \times 0.6$ $R_M - 10 = 10 \div 0.6$ Risk Premium = 16.67%	$R_A = R_F + (R_M - R_F) \times \beta$ $30 = 10 + (R_M - 10) \times 1.20$ $(R_M - 10) = 20 \div 1.20$ Risk Premium = 16.67%
Required Return	$R_M = 10+16.67 = 26.67\%$	$R_M = 10+16.67 = 26.67\%$

(iii) The expected rate of Return on Debt is 10% i.e. Risk-free rate.

(iv) The percentage increase in EPS :

	Before Buy-back	**After buy-back**
Equity	100	50
Debt @ 10%	NIL	50
Total	100	100
EBIT @ 20%	20	20
Less : Interest	NIL	5
Earnings	20	15
No. of shares	100	50
Earnings per share	0.20	0.30
P/E Ratio	5	3.33
Return on Equity	20%	30%

The percentage increase in EPS is 50% i.e. (0.30 – 0.20) ÷ 0.20×100 = 50%

The New Price Earnings Multiple is **3.33**.

Answer 4. (b)

Banking Ombudsman :

The Reserve Bank of India (RBI) brought about crucial amendments to the Banking Ombudsman Scheme, 2006 which will now enable aggrieved customers to not only appeal against any Ombundsman's decision but also to appeal in case of complaints being rejected. The appeal could be made to the deputy governor's office of the RBI.

The Ombudsman, however, has the right to reject complaints if they are; not on the grounds of complaint referred to in clause 8; beyond the pecuniary jurisdiction of Banking Ombudsman prescribed; frivolous, vexatious, malafide; without any sufficient cause; that it is not pursued by the complainant with reasonable diligence; in the opinion of the Banking Ombudsman there is no loss or damage or inconvenience caused to the complainant; or requiring consideration of elaborate documentary and oral evidence and the proceedings before the Banking Ombudsman.

In case of a complaint being aggrieved by the award under clause 12 or by rejection of a complaint, he may exercise the option of an appeal within 30 days, the RBI said in its notification.

Answer 4. (c)

(i) The first one indicates that SBI stock futures are traded now at ₹ 1441. They expire on the last Thursday of March, 2012. Mr. Karuna has to deposit 10% of 1441 × 100 = ₹ 14410 as initial margin.

(ii) The second one indicates that NIFTY Index futures are traded now at 4280. They expire on the Last Thursday of April 2012.

Mr. Karuna has to deposit 10% of 4280×100 = ₹ 42800 as initial margin.

Section - II (40 Marks)
(Corporate Laws)

Answer **Question No. 5** *(carrying 10 marks) which is compulsory and answer* **any two** *(carrying 15 marks each) from the rest in this Section.*

Q. 5. (a) Choose the most appropriate one from the stated options and write it down (only indicate A or B or C or D as you think correct)

(i) Which of the following statements is true, in respect of constitute an 'Audit Committee' under section 292A of the Companies Act, 1956?'

(A) The Audit Committee shall have a minimum of three members.

(B) The members of an Audit Committee are elected by the members of a Company in general meeting.

(C) All Companies whether private or public have to constitute an Audit Committee.

(D) None of the above.

(ii) If in a general meeting of a Company, a matter could not be resolved because of tie, then

(A) Meeting will be adjourned

(B) Meeting will be postponed

(C) Chairman of the meeting can give his second/casting vote

(D) Managing Director can give his casting/second vote

(iii) The Competition Commission shall consist of a chairperson and not less than two but not more than __________ other members to be appointed by the Central Government. (Fill in the gap from the below.)

(A) 7

(B) 10

(C) 5

(D) None of the above.

(iv) Which of the following committee set up by SEBI had submitted its report in February, 2003 on Corporate Governance?

(A) Narasimham Committee

(B) Kumar Mangalam Birla Committee

(C) Narayana Murthy Committee

(D) Naresh Chandra Committee.

(v) In the context of classification of Risks, System Risks fall under :

(A) Obsolescence risks

(B) War Risks

(C) Tax Risks

(D) Contract Risks [1×5=5]

(b) Fill in the blanks in the following sentences by using appropriate word(s)/phrase(s)/number(s) :

(i) The prospectus issued by a financial institution for one or more issues of securities specified therein, is called __________ prospectus.

(ii) When two firms working in different stages of production of the same product combine, __________ merger takes place.

(iii) The requirement of minimum 50 percent of the total number of directors to be independent directors in the case of listed companies, is mandated by Clause __________ of the Listing Agreement.

(iv) As regards corporate governance, apart from those mandated by the Listing Agreement, section __________ of the Companies Act, 1956 contains additional requirements.

(v) __________ is not a linear process; it is the balancing of a number of interwoven elements.

[1x5=5]

Answer 5. (a)

(i) (A)

(ii) (C)

(iii) (B)

(iv) (C)

(v) (A)

Answer 5. (b)

(i) Shelf

(ii) Vertical

(iii) 49

(iv) 292A

(v) Risk Management

Q. 6. (a) The General norms is that after the risk identification takes place, the actions involved in pinpointing suitable responses to the risk are broadly of five types.

__________ Sketch these five types of actions. [6]

(b) SHAKSHI TELECOM LTD., a private mobile operator had furnished confidential information relating to customer complaints lodged with the company during the quarter ended 31.3.2012 to a public authority. On an application under the Right to Information Act, 2004, the public authority wants to furnish the said information. The authority seeks the objections of SHAKSHI TELECOM LTD.

Can SHAKSHI TELECOM LTD. ask the public authority not to furnish the same on the grounds that the said information is confidential and that it may endanger its image in the market?

What decision should the public authority take? [5]

(c) The Competition Commission has served notice on VIPUL PAINTS LTD. to look into alleged contravention of certain provisions. The company wants to object to the same on the ground that the same was consequent to a complaint made by the State Government, which is not in order.

Advise the company suitably. [4]

Answer 6. (a)

Action taken after identification of risks :

The actions break into broadly five types, as shown below :

(i) Prevention terminates the risk - by doing things differently and thus removing the risk where it is feasible to do so. Countermeasures are put in place that either stop the threat or problem from occurring or prevent it having any impact on the project or business.

(ii) Reduction threat the risk- take action to control it in some way where the actions either reduce the likelihood of the risk developing or limit the impact on the project to acceptable levels.

(iii) Transference – This is a specialist form of risk reduction where the management of the risk is passed to a third party via, for instance, an insurance policy or penalty clause, such that the impact of the risk is no longer an issue for the health of the project. Not all risk can be transferred in this way.

(iv) Acceptance – tolerate the risk- perhaps because nothing can be done at a reasonable cost to migrate it or likelihood and impact of the risk occurring are at an acceptable level.

(v) Contingency – these are actions planned and organized to come into force as and when the risk occurs.

Any given risk could have appropriate actions available to deal with a risk, in which case the risk must be accepted or the justification for the project revisited (to review whether the project is too risky), possibly resulting in the termination of the project.

The results of the risk evaluation activities are documented in the Risk Log. If the project is part of a programme, project risk should be examined for any impact on the programme (and vice versa).

Where any cross-impact is found, the risk should be added to the other Risk Log.

Answer 6. (b)

SHAKSHI TELECOM LTD.

Disclosure of Information treated as confidential by third party :

As per section 11 (1) of the Right to Information Act, 2004 where a public authority intends to disclose any information or record, or part thereof on a request made under this Act which relates to, or has been supplied by a third party and has been treated as confidential by that third party, the Public Information Officer shall, within five days from the receipt of a request, give written notice to such third party of the request and of the fact that the public authority intends to disclose the information or record, or part thereof and invite the third party to make a submission, in writing or orally, regarding whether the information should be disclosed, which submission shall be taken into account when determining whether to disclose the information.

Provided that except in the case of trade or commercial secrets protected by law, disclosure may be allowed if the public interest in disclosure outweighs in importance any possible harm or injury to the interests of such party.

SHAKSHI TELECOM LTD. cannot ask the public authority not to furnish the same on the grounds that the said information is confidential and that it may spoil its image in the market. This is not trade or commercial secrets protected by law. Hence the public authority should overrule the objections of SHAKSHI TELECOM LTD and furnish the information to the applicant under the RTI Act.

Answer 6. (c)

Inquiry into certain agreements and dominant position of enterprise :

As per section 19 (1) of the Competition Act, 2000, the Competition Commission may inquire into any alleged contravention of the provisions contained in subsection (1) of section 3 or sub-section (1) of section 4 either on its own motion or on -

(a) receipt of a complaint, accompanied by such fee as may be determined by regulations, from any person, consumer or their association or trade association ; or

(b) a reference made to it by the Central Government or a State Government or a statutory authority.

It can be seen from above that a State Govt. can refer the matter to Competition Commission. Hence the company cannot raise an objection that the Competition Commission cannot enquire into the alleged violations on the strength of reference made by the State Government.

Advice should be tendered on the above lines.

Q. 7. (a) Discuss the role of Nomination Committee in the context of the principle of Corporate Governance. What are the principal functions and responsibilities of the Governance and the Nomination Committee in this regard? [2+6=8]

(b) What is meant by oppression? State whether the aggrieved party would succeed in obtaining relief from Company Law Board on the ground of oppression in the situations given below :

(i) The complaint is by the minority Directors that the majority of the Board of Directors override the minority Directors;

(ii) A petition by majority shareholders complaining oppression by minority shareholders. [4+3=7]

Answer 7. (a)

Nominating Committee : Role

The governance and Nominating Committee's role is to determine the state of director nominees for election to the Company's Board of Directors to identify and recommend candidates to fill vacancies occurring between annual shareholder meetings, to review, evaluate and recommend changes to the Company's Corporate Governance Guidelines, and to review the company's policies and programs that relate to mater of corporate responsibility, including public issues of significance to the company and its stakeholder.

Responsibilities and functions of the governance and Nominating Committee

Subject to the provisions of the Corporate Governance Guidelines, the principal responsibilities and functions of the governance and Nominating Committee are as follows :

1. Annually evaluate and report to the Board of the performance and effectiveness of the Board to facilitate the directors fulfilling their responsibilities in a manner that serves the interests of corporate shareholders.
2. Annually present to the Board a list of individuals recommended for nomination for election to the Board at the annual meeting of shareholders, and for appointment to the committees of the Board (including this committee). Review and consider shareholder recommended candidates for nomination to the Board.
3. Before recommending an incumbent, replacement or additional director, review his or her qualifications, including capability, availability to serve, conflicts of interest, and other relevant factors.
4. Assist in identifying, interviewing and recruiting candidates for the Board.
5. Annually review the composition of each committee and present recommendations for committee memberships to the Board as needed.
6. Develop and periodically review and recommend to the Board appropriate revisions to the Company's Corporate Governance Guidelines.

7. Monitor compliance with the Corporate Governance Guidelines.
8. Regularly review and make recommendation about changes to the charter of Governance and Nominating Committee.
9. Regularly review and make recommendation about charges to the charter of other Board committees after consultation with the respective committee chairs.
10. Obtain or perform an annual evaluation of the Committee’s performance and make applicable recommendations.
11. Assist the Chairman of the ‘Board, if the Chairman is a non-management director, or otherwise the Chairman of the Committee acting as Lead Independent Director, in leading the Board’s annual review of the Chief Executive Officer’s performance.
12. Annually review the Company’s policies and programs that relate to corporate responsibility.

Answer 7. (b)

Oppression :

The term oppression’ is not defined in the Companies Act, 1956. Oppression, according to the Dictionary meaning of the word, is any act exercised in a manner burdensome, harsh and wrongful. The meaning of the term ‘oppression’ was explained by Lord Cooper in the Scottish case of **Elder** *v.* and **Watson Ltd**, as given below :

“The conduct complained of should be at lowest involve or visible departure from the standards of fair dealing and a violation of the conditions of fair play or which every shareholder who entrusts his money to a company is entitled to rely.”

(i) **Majority group of the Board overriding the minority group :** The oppression dealt with by section 397 is only oppression of members in their character as such, and it is only in that character they can involve section 397. The harsh treatment, for instance, of a member who is a Director or other officer or employee, by the Board of Directors or management does not come within (section 397). It has been held in Re. Bellador Silk Ltd. that if the majority of the Board of Directors override the minority Directors the latter cannot resort to section 397 and hence the minority Directors will not succeed in getting relief from CLB on the ground of oppression.

(ii) **Right not confined to minority :** According to section 399, the right to apply for relief under section 397/398 is given to 100 members or $1/10^{th}$ of the total numbers or any member or members holding not less than $1/10^{th}$ of the issued share capital of the company. There is nothing in this section which suggests even indirectly that unless the application is made by minority shareholders it is not maintainable. The right to apply is, therefore, not confined to oppressed minority of the shareholders alone. It was held by Calcutta High Court in Re. Sindhri Iron Foundry (P) Ltd. that the oppressed majority also might apply for relief under Section 397. Therefore, the petitioners are likely to succeed in getting relief provided the other condition laid down in section 397 (i.e. that to wind up the company would unfairly prejudice such members, but that otherwise the facts would justify the making of a winding-up order on just and equitable ground) is satisfied, even though the Delhi High Court held a contrary view in Suresh Kumar Singhi v. Supreme Motors Ltd.

Q. 8. (a) What is the role of SEBI in promoting Corporate Governance? [5]

(b) MR MUKHOPADHYAY was appointed as director of EXCEL FITTINGS LTD., a public limited company on 1.2.2012. He bought 1000 equity shares of ₹ 10 each from his cousin on 11.06.2012.

Discuss the compliance with the applicable provisions of the Companies Act, 1956 relating to qualification shares and the ensuing consequences. [5]

(c) The Board of Directors of GREEN ENVIRON LTD. at a meeting held on 15.1.2012 resolved to borrow a sum of ₹ 50 crores from a Nationalised Bank. Subsequently the said amount was received by the Company. One of the Directors who opposed the said borrowing as not in the interest of the Company has raised an issue that the said borrowing is outside the powers of the Board of Directors.

The Company seeks your advice and the following data is given for your information:

(i)	Share Capital (Paid-up)	₹ 15 crores
(ii)	Reserves and Surplus	₹ 20 crores
(iii)	Secured Loans	₹ 50 crores
(iv)	Unsecured Loans	₹ 15 crores

Advice the Management of the Company (Green Environ Ltd.). [5]

Answer 8. (a)

Good Governance in capital market has always been high on the agenda of SEBI. This is evident from the continuous updation of' guidelines, rules and regulations by SEBI for ensuring transparency and accountability. In the process, SEBI had constituted a Committee on Corporate Governance under the Chairmanship of Shri Kumar Mangalam Birla.

Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges in the year 2000. These principles of Corporate Governance were made applicable in a phased manner and all the listed companies with the paid up capital of ₹ 3 crores and above or net worth of ₹ 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

SEBI, as part of its endeavour to improve the standards of corporate governance in line with the needs of a dynamic market, constituted another Committee on Corporate Governance under the Chairmanship of Shri N. R. Narayana Murthy to review the performance of Corporate Governance and to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market.

With a view to promote and raise the standard of Corporate Governance, SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of power conferred by Section 11(1) of the Securities and Exchange Board of India Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, revised the existing clause 49 of the Listing agreement vide its circular SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003. It clarified that some of the sub-clauses of the revised clause 49 shall be suitably modified or new clauses shall be added following the amendments to the Companies Act 1956 by the Companies (Amendment) Bill/ Act 2003, so that the relevant provisions of the clauses on Corporate Governance in the Listing Agreement and the Companies Act remain harmonious with one another.

Answer 8. (b)

The Companies Act, 1956 does not provide for any share qualification of any Director but Regulation 66 of Table 'A' provides that a Director must hold at least one share in the company. Usually, the Articles of the Company provided for holding qualification shares by a Director. Where a share qualification has been prescribed in the Articles of a company which is a public company or a private company which is a subsidiary of a public company, the provisions of Section 270 of the Companies Act, 1956 is applicable where-under, a Director must take his qualification shares within 2 months after his appointment. Any provision in the Articles of the company shall be void in so far as it requires a person to hold the qualification shares before his appointment as a Director or to obtain them within a shorter time than two months after his appointment as a Director or to obtain them within a shorter time than two months after his appointment as such. The nominal value of the qualification shares shall not exceed ₹ 5,000/- or where nominal value exceeds ₹ 5,000, share qualification will be one share.

A person acting as a Director without acquiring qualification shares is punishable under Section 272 of the said Act. Moreover, a Director who fails to hold qualification shares is also liable to vacate his office under Section 283 of the Companies Act, 1956.

In the instant case Mr. Mukhopadhyay was appointed as Director of EXCEL FITTINGS Limited on 1st February, 2012, he bought the shares from his cousin only on 11-06-2012, which were registered the same day. It can not therefore be said that he held the shares before expiry of 2 months from the date of his appointment. In view of this Mukhopadhyay has to vacate the office and is also punishable u/s 227.

Answer 8. (c)

According to the provisions of Section 293(1)(d) of the Companies Act, 1956 there are restrictions on the borrowing powers to be exercised by the Board of Directors. According to that section, the borrowings should not exceed the aggregate of the paid up capital and free reserves. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of the business will be excluded. However, from the figures available in the present case the proposed borrowing of ₹ 50 crores will exceed the limit mentioned. Thus the borrowing will be beyond the powers of the Board of Directors. However the share holders have the power to ratify the act of the Board of Directors, if it not beyond the powers of the company as laid down in the memorandum of association. In that case the shareholders can rectify as it is intra vires the Company even though it may be beyond the powers of the Board of Directors.

Thus the management of GREENENVIRON LTD, should take steps to convene the annual general meeting and pass a resolution by the members in the meeting as stated in Section 293(1)(d) of the Act. Then the borrowing will be valid and binding on the company and its members.