

MOCK TEST PAPER
FINAL COURSE: GROUP – II
PAPER – 6B: FINANCIAL SERVICES AND CAPITAL MARKETS

*The question Paper comprises **five** case study questions. The candidates are required to answer any **four** case study questions out of five.*

CASE STUDY: 1

Saransh Garments Private Limited was formed on January 1, 2018, by Amit Sharma, Sumit Sharma, and Garvit Sharma. On April 1, 2020, it was converted into a public limited company and a fresh certificate of incorporation was issued. Saransh manufactures and exports various garments like shirts, trousers, T-shirts, undergarments, etc. under the brand name, 'Shera'. In the Latin American companies, it sells shirts and trousers through its premium brand 'family' and a popular segment brand 'Sensation', and in the UK also under the same brand name. Its manufacturing unit at Sanand, Gujarat has recently increased its capacity. A new project for manufacturing the latest style in Mumbai was also started in FY20.

The Indian garment industry is the big one now. According to data from McKinsey's Fashion Scope, India's clothing and garment market is forecasted to be worth over \$59.3 billion in 2022, sustaining its leadership position as the sixth largest clothing manufacturing country in the world.

At a recent board meeting of the company, Amit Sharma, Chairman of the company, apprised Sumit Sharma, Chief Executive Officer, and Garvit Sharma, Chief Financial Officer, of the dramatic change in return on equity, which increased substantially in FY20. However, Garvit Sharma, CFO of the company is concerned about the financial position of the company.

To grow its business, the company has to acquire new clients and build its cash reserve. This reserve is required to meet variable costs as customer payment will take 90 days (Normal credit allowed to clients). The current financial position is not well to grow the business and take on new clients.

After being denied a bank loan, the company is looking for a finance company who are providing the service of factoring. With factors help, Saransh Garments will quickly gain access to cash equalling and will be able to fund its operations; without having to wait for the customers to pay and without incurring any debt.

Saransh has invited proposals from various factors and also provided them with an extract of financial and operational data to evaluate and submit the proposal to the company. The details are as follows:

Sr. No.	Particulars	₹ in crore
1	Annual Turnover	4000
2	Variable Cost (60%) *	2400
3	Fixed Cost (Rent, Administrative expenses etc.)	500
4	Profit	1100

*(Also includes bad debts – company experience indicates that bad debt losses are 3% of turnover)

Garvit Sharma has got a proposal from a factor that will provide factoring services on a recourse basis. The proposal is as below:

- The factor will keep the reserve equal to 15% of the amount after adjusting commission and 10% of receivable
- Commission charges 1.50%
- Interest rate is 16% p.a.

- The factor will provide an advance after adjusting reserve, commission charges, and interest amount.

The factoring is expected to save ₹ 100 crores as administrative costs (Fixed Cost).

During this time, Mr. Amit Sharma informed the management that they have received an order of ₹ 1000 crore which is big enough in terms of contribution to the profits.

The year represents 360 days.

Questions

Based on above, answer the following questions:

1. Compute amount paid as advance by factor considering Saransh Garments has accepted the proposal of factor. **(4 Marks)**
2. Compute Net Factoring cost (%). **(4 Marks)**
3. Saransh Garments has opportunity to accept new orders of ₹1000 crore. Company has to accept current proposal from factor if they wish to grab this opportunity. Suggest Saransh whether it should accept new orders. **(7 Marks)**
4. Multiple Choice Questions (MCQs) **(10 Marks)**
 - (i) Which among the following is not a step in the process of factoring?
 - (a) Customer places an order with the client for purchase of goods and/or services on credit.
 - (b) On the basis of agreement, the client delivers the goods and sends the invoice to customers.
 - (c) The client then assigns the invoice to the factor.
 - (d) The factor, then, makes prepayment up to a maximum amount of 50 per cent of the invoice value to the client.
 - (ii) Which among the following is not a function of factor?
 - (a) The factor maintains the clients' sales ledgers.
 - (b) The factor undertakes to collect the receivables on behalf of the client.
 - (c) Assumptions of interest rate risk is one of the most important functions of the factor.
 - (d) It also provides advisory services to its clients.
 - (iii) Which among the following best explains the difference between forfaiting and export factoring?
 - (a) A forfaiter discounts 70-80% of the entire value of the note/bill. In a factoring arrangement the extent of financing available is 80-90%.
 - (b) Forfaiting is a pure financial agreement while factoring includes ledger administration as well as collection.
 - (c) Factoring is a long-term financial deal whereas Forfaiting is a short-term financing deal.
 - (d) The forfaiter's decision to provide financing depends upon the credit standing of the availing bank. On the other hand, in a factoring deal the export factor bases his credit decision on the financial standards of the exporter.
 - (iv) A new company that has been granted Certificate of Registration (CoR) by the RBI as NBFC-Factor shall commence business within from the date of grant of CoR by the RBI.
 - (a) three months
 - (b) six months

- (c) nine months
- (d) one year
- (v) A non-banking financial company can be engaged in factoring business if its income from factoring business is more than of the gross income or such per cent as may be stipulated by the Reserve Bank of India.
 - (a) fifty per cent
 - (b) sixty per cent
 - (c) seventy-five per cent
 - (d) one-hundred per cent

CASE STUDY: 2

Mr. Suresh Sinha, the Chief Executive Officer (CEO) of a leading credit rating agency has sought the opinion of his newly appointed Chief Rating Officer (CRO) Mr. Gautam Dangi. The CEO was concerned about the recent criticism about the working of the credit rating agencies, especially after the IL&FS fiasco. The CRO apprised him of the recent developments in the field of credit rating, measures adopted by the other credit rating agencies to improve their rating process, and the steps regulators such as SEBI and RBI are taking. These are discussed in the following paragraphs.

Credit rating agencies (CRAs) are in the limelight, despite the fact that various steps have been taken to address the problems they face. Some issues that surfaced during the global financial crisis of 2008 remain unaddressed, while developments that led to the danger of revocation of a major market intermediary's licence indicate that flaws in the rating process still exist.

Rating companies claim that they have taken steps to solve the problems, such as hiring from outside sources and leveraging technology to ensure that the entire process is streamlined and automated.

Industry analysts, on the other hand, claim that CRAs still lack an evaluation tool for identifying new business risks. They emphasise that rating agencies must employ better market knowledge rather than relying on previous data. Rating firms have also been facing certain regulatory challenges, particularly real-time information on bank defaults.

Gautam Dangi, the CRO opined that CRAs may lack the appropriate evaluation models to recognise new business risks, which could have an impact on the rating action they take. As a result, the ratings do not always reflect the company's or instrument's financial soundness. Liquidity risk was a typical example during the global financial crisis, and it's still a problem for them today.

Furthermore, there is a lack of cooperation between the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI) when it comes to bank loan default disclosure by listed businesses. Many times, CRAs have petitioned the SEBI and the RBI to request new disclosure rules.

CRAs believe that the varied disclosure rules for bond and bank loan defaults could lead to information asymmetry and render the rating process vulnerable to manipulation.

In the case of bonds, any interest or principal repayment default is currently disclosed promptly. Companies are given a 30-day grace period before the disclosure requirements apply to bank loans.

The RBI accredits CRAs because their primary role is to rate debt securities such as bank loans, nonconvertible debentures (NCDs), commercial papers, and certificates of deposits. The CRA ratings that these products receive are crucial because they influence pricing and investment decisions.

Where the regulator's viewpoint differs from that of other stakeholders, according to the CRO, proactive communication is required. A consultative approach could prevent AT-1 (additional tier-1) bonds from producing unpleasant surprises for investors.

The AT-1 bonds are part of the Yes Bank reorganisation plan, which was revealed in March 2020. Apart from retail investors and mutual funds, the YES Bank crisis exposed a new class of investors to significant risk. Since the restructuring process allowed the firm to extinguish its existing ₹ 8,415 crore AT1 bonds, holders of AT-1 bonds, also known as perpetual bonds, have suffered losses. Rating agencies, on the other hand, claim to be on a long, transformative journey.

"Our board of directors is brand new, and we've been working hard to improve our rating systems and governance." External hires have also been recruited to supplement the existing team of specialists and ensure that modifications can be made as needed. In response to a media inquiry, a CARE rating spokeswoman said, "The firm has a new MD and CEO, a chief rating officer (CRO), chief financial officer, head legal, compliance and secretarial, and a chief culture officer at the leadership."

It also stated that rating oversight and governance had been enhanced, with the CRO reporting to the board's risk sub-committee.

CARE Ratings also has an external risk supervisory committee made up of senior and independent professionals who assess and provide ideas on its ratings on a regular basis.

SEBI has recently requested the dismissal of prominent officials from rating organisations. The cancellation of a licence, on the other hand, is an extreme move that regulators may contemplate if there are repeated failures, stated the CRO.

Previously, CRAs were content to rely on the financial information provided by management. There was a lack of the required further due diligence. That isn't to say that CRAs haven't evolved. Because of the heightened scrutiny, CRAs would prefer to let an incorrect client or rating go than continue to offer ratings, Gautam Dangi added.

Several key executives at rating agencies resigned as a result of the IL&FS crisis in 2018. Following charges of impropriety, Moody's India unit, ICRA, fired its managing director and CEO, Naresh Takkar, in August 2019. Rajesh Mokashi, the managing director and CEO of CARE, was forced to resign in December 2019 after whistle-blower reports surfaced alleging management meddling in the ratings of select companies, including IL&FS. S B Mainak, the chairman of CARE, also announced his resignation in February 2020.

Questions:

Based on above, answer the following:

1. What is a credit rating agency and why they are important? **(5 Marks)**
2. Why credit rating agencies are criticized recently? Discuss this with the help of recent instances citing the business model they adopt. **(6 Marks)**
3. Explain with examples how the efficiency of credit rating has been increased after the IL&FS fiasco. **(4 Marks)**
4. Multiple Choice Questions (MCQs) **(10 Marks)**
 - (i) Credit rating is linked with
 - (a) Performance evaluation of the rated entity
 - (b) The opinion on risk evaluation
 - (c) Legal compliance by the issuer entity through audit

- (d) Opinion on the holding company, subsidiaries or associates of the issuer entity
- (ii) Which among the following is not an objective of credit rating?
 - (a) Rating debt obligations of companies
 - (b) Rating of equity shares of companies
 - (c) Creating awareness of the concept of credit rating
 - (d) Helps in creating confidence in the minds of investors
- (iii) An employee of a company mistakenly paid ₹ 1,00,000 instead of ₹ 10,000 can be considered as a
 - (a) Credit Risk
 - (b) Liquidity Risk
 - (c) Operational Risk
 - (d) Market Risk
- (iv) Which among the following is not a limitation of credit rating?
 - (a) Ratings given to instruments can change over a period of time
 - (b) Downgrades are linked to industry rather than company performance
 - (c) The rating agency collects fees from the entity it rates leading to a conflict of interest
 - (d) Provides analysts in Mutual Funds to use credit ratings as one of the valuable inputs to their independent evaluation system
- (v) Globally credit decisions are based on
 - (a) probability of default
 - (b) tracking deviations of bond spreads
 - (c) both (a) and (b)
 - (d) None of the above

CASE STUDY: 3

Mr. Ajit, a CEO of a company is worried about the recent activism of SEBI towards insider trading transactions. He called his finance manager Sujit for advice in this respect. Mr. Sujit, a Chartered Accountant by profession explained the recent instances of insider trading and the capital market regulator SEBI's dedicated efforts to curb insider trading in India. His observations are discussed in the following paragraphs.

As insider trading becomes more sophisticated, the Securities and Exchange Board of India (SEBI) is updating its surveillance system. Insiders or their proxies would purchase and sell shares based on insider information in the past. However, in order to make a quick buck and avoid the law, they have begun to employ complicated derivative methods.

As a result, the market regulator is working on in-house technology to scan all derivative trades and identify problematic ones. Experts estimate that the new system checks approximately 20 million trades per day. Another expert stated that while an insider or his proxies can directly determine the intent to buy or sell, doing so with derivatives is extremely difficult. The new platform scans and analyses data.

A normal trader would not take such massive unhedged holdings unless he had some kind of insider information about the company. It also gathers data from other sources. The new platform's signals are far

more sophisticated than the old insider trading alerts, and they have helped SEBI's surveillance of the complicated equity derivative market, which includes futures and options contracts.

The platform's capabilities do not end there. It also creates a database of suspected transactions, as well as the traders that carried them out. This tool will assist SEBI in identifying patterns. If a trader engages in such activities on a regular basis, the system will detect it and notify the regulator. Then further information can be uncovered.

Insider trading is a deceptive and unlawful practice that occurs on stock exchanges all around the world. It entails trading in a company's stock using information that isn't available in the public domain.

Insider trading occurs when firm insiders, such as important personnel with access to the company's strategic plans, use them to make a profit. The market regulator, SEBI, strongly opposes it.

To be specific, information that is not publicly available and has the potential to significantly influence an investor's choice to purchase or sell a security. UPSI, as defined by SEBI, is unpublished price sensitive information.

Is insider trading always considered unwelcome?

While trading on UPSI is against the law, it isn't entirely evil. Many firm executives, by virtue of their position, will always own UPSI while trading in the company's stock.

They can do so by selling their stock option programme (ESOP) holdings for personal or professional reasons. Indeed, many company executives had to liquidate their holdings to create funds to subscribe to shares in the new ESOP. Others stated that they have been liquidating for some time in order to satisfy other obligations.

That's actually not a negative thing. Such trades are not considered illegal if they are declared to stock exchanges in accordance with SEBI requirements. Given this, a correct indication is required.

How can we tell which form of insider trading is good?

Companies must declare the transactions carried out by key executives in accordance with compliance rules. It discovered that some bank and financial institution CEOs, as well as promoters of mid-and small-cap enterprises, have reduced their stakes in recent months.

While this does not always imply insider trading, the increasing number of instances of selling while the market is at all-time highs makes one suspicious.

What impact does insider trading have on the market?

In the capital markets, information is possibly more valuable than the official currency. When concealed knowledge can have a significant impact on the price, traders should use it.

If everyone has access to timely information every investor takes advantage of that. Retail traders will be unable to win in such a market if insiders continue to use the information to their advantage.

Furthermore, if domestic and overseas investors learn of widespread insider trading in the market, they will swiftly lose faith and seek alternative investment opportunities.

Questions

Based on above, answer the following questions:

1. How SEBI is curbing the menace of insider trading in India? Discuss with reference to SEBI (Prohibition of Insider Trading) Regulations, 2015. **(5 Marks)**
2. Insider Trading is not considered bad in certain situations. Explain those situations by referring to SEBI (Prohibition of Insider Trading) Regulations, 2015. **(5 Marks)**

3. Discuss the institutional mechanism to be mandatorily executed by the companies to prevent insider trading. **(5 Marks)**
4. Multiple Choice Questions: **(10 Marks)**
- (i) The board of directors or head(s) of the organization of every person required to handle unpublished price sensitive information shall ensure that the structured digital database is preserved for a period of not less than after completion of the relevant transactions.
 - (a) three years
 - (b) five years
 - (c) eight years
 - (d) ten years
 - (ii) A trading plan formulated by an insider shall have to be reviewed by the
 - (a) Chief Executive Officer
 - (b) Chief Financial Officer
 - (c) Chief Operating Officer
 - (d) Compliance Officer
 - (iii) Who among the following will not be required to disclose his holding of securities of the company within seven days of his appointment?
 - (a) Key Managerial Personnel
 - (b) Director of a listed company
 - (c) Chief Operating Officer
 - (d) member of the promoter group
 - (iv) Members of board of directors and key managerial personnel shall disclose to the board of directors whether they, directly, indirectly, or on behalf of third parties, have a in any transaction or matter directly affecting the listed entity.
 - (a) material interest
 - (b) beneficial interest
 - (c) deep interest
 - (d) overall interest
 - (v) Board of directors shall have an optimum combination of executive and non-executive directors with at least woman director and not less than of the board of directors shall comprise of non-executive directors.
 - (a) one/fifty
 - (b) one/one-third
 - (c) two/fifty
 - (d) two/one-third

CASE STUDY: 4

(a) Following the Chitra Ramkrishna affair regarding the NSE co-location case, the Securities and Exchange Board of India (SEBI) strengthened laws governing Market Infrastructure Institutions (MIIs). The

markets regulator agreed to conduct a comprehensive review of MII laws less than two months after Ramkrishna resigned as managing director (MD) and chief executive officer (CEO) of the National Stock Exchange (NSE) in December 2016.

MIIs, such as stock exchanges, clearing organizations, and depositories, are systemically significant institutions. They are the capital markets' backbone.

SEBI established an expert committee in this regard, which met for the first time on October 9, 2017, under the chairmanship of former Reserve Bank of India deputy governor R Gandhi. On March 26, 2018, and April 25, 2018, the committee submitted its report in two sections. SEBI then requested public comment on the panel's recommendations, and at its board meeting on June 21, 2018, authorized amendments to the applicable MII circulars.

The main improvements made were targeted at giving MIIs more oversight and plugging in the gaps that allowed misgovernance at NSE. Even though he was second-in-command at NSE, Anand Subramanian was not classified as key management personnel (KMP). Ravi Narain had been the MD and CEO of NSE for a long time.

Here are some of the changes undertaken by SEBI:

MD's term has come to an end

A maximum of two five-year periods were authorized by the MD of an exchange.

Furthermore, the appointment procedure had to be repeated after the first term.

The MII board had previously extended the tenure without a proper appointment process. The extension will be subject to a performance review, SEBI approval, and the invitation of new applications under the new method.

KMP restrictions have been tightened.

The term KMP has been expanded to encompass anyone who reports directly to the CEO or is two rungs below the CEO. Furthermore, the ratio of remuneration provided to KMPs vs. the median of all employees' compensation had to be revealed.

Subramanian was promoted to NSE's group operating officer and paid more than numerous vertical heads, but he was not classified as a KMP. The new rules will assist to avoid a situation like this.

Public interest directors (PIDs) have their terms limited.

PIDs are authorized for a maximum of three three-year terms and a maximum of two terms with one MII. In addition, the initial term will only be extended after a performance evaluation. PIDs were requested to disclose any potential conflicts of interest, such as their ties to any of the companies on the list. For PIDs to become shareholder directors, a three-year cooling-off period is required.

As a result of the Ramkrishna incident, PIDs' position and fiduciary responsibilities have received increasing attention.

On internal committees

Internal committees were consolidated and reduced from fifteen to seven in order to improve efficiency and eliminate overlap.

At least an equal number of PIDs and shareholder directors must serve on MII governing bodies and regulatory committees. In the event of a tie, the chairperson (who is also a PID) allowed for a second vote.

Subramanian's nomination and remuneration are said to have been approved improperly by the Nomination and Remuneration Committee (NRC). Having a greater or equal number of PIDs will help to diminish management's influence in internal committees like the NRC.

Observance of regulations

MIIs have been required to reveal the amount of money they have set aside for regulatory functions.

It will aid in the separation of an MII's commercial and regulatory obligations.

(b) According to persons acquainted with the co-location case, India's market regulator has formed a committee to investigate failures at the National Stock Exchange of India during the tenure of its previous chief executive officer, Chitra Ramkrishna, and recommend ways to enhance such essential institutions.

According to the persons, the panel will look into the country's largest stock exchange's internal control systems and compliance methods.

The Securities and Exchange Board of India has formed a committee to investigate the causes of the lapses at multiple levels, including the board, the regulator, and the government, and to recommend checkpoints and tighter controls to ensure that such problems do not occur again.

G Mahalingam, a former whole-time director at SEBI and chairperson of the Advisory Committee for the SEBI Investor Protection and Education Fund, will lead the committee. Mahalingam was a visiting faculty member at the National Institute of Securities Markets, an educational project of SEBI, and a former regional director of the Reserve Bank of India.

In February, the Securities and Exchange Board of India (SEBI) charged Ramkrishna and other NSE officials with alleged governance lapses and securities contract rule violations in the hiring and appointment of Anand Subramanian as a chief strategic advisor and his subsequent re-designation as group operating officer and advisor to MD.

According to the market regulator, Ramkrishna communicated secret corporate information with a mysterious "Himalayan yogi" who was also consulted about staff performance appraisals, including NSE financial and business strategies and financial results. Ramkrishna said that the "Himalayan yogi" advised her in making important business decisions.

Ramkrishna is currently in judicial detention in connection with the so-called "co-location" affair, in which some stock traders were allegedly given preferential access to information on the NSE's servers from 2010 to 2015.

Last year, the NSE was the world's largest derivatives exchange, with an average daily volume of ₹ 2 lakh crore. In terms of the number of trades in the cash equities section, it is rated fourth in the globe.

By exposing the core causes of wrongdoings and the efforts taken to cover them up, SEBI hopes to clean up and streamline existing processes and practices.

According to the regulator, the NSE is a Market Infrastructure Institution (MII), which includes stock exchanges, depositories, and clearing houses, all of which are critical components of the country's economic infrastructure. The term 'market infrastructure' denotes fundamental facilities and systems that serve the Indian capital markets.

All MIIs have two responsibilities: they are the first-level regulators, and they must keep track of price-sensitive data. Because regulatory protection is a key element of their role, secretarial and audit committees must be strengthened and must investigate all aspects of the exchange's day-to-day operations.

Second, they are a public utility, which necessitates fair and equitable access. As a result, cybersecurity is another area that requires improvement.

Key aspects

According to sources familiar with the situation, the committee will delve into five key areas to restore investor trust and confidence.

- (1) **Commercial:** The commercial side is important since an institution like the NSE needs to be profitable to operate efficiently and enhance its trading and security systems, as well as offer new products.
- (2) **Technology:** MIs should be well-equipped to deal with the intricacies of business on a day-to-day basis. It must do so by investing in technology, which will help it deliver regulatory requirements more efficiently and effectively, as well as support supervision in terms of proactive risk and compliance monitoring at financial institutions.
- (3) **Measures for evaluation:** The group will work to develop comprehensive metrics for evaluating MIs and holding officials accountable.
- (4) **Omissions and commissions:** Omissions and commissions must be eliminated at all costs. The committee's focus will most likely be on eliminating omission errors.
- (5) **Framework:** The committee may look into a governance structure that will allow for tighter compliance and better scrutiny, preventing shortcuts and protecting the system from being duped.

Questions

Based on above, answer the following questions:

1. What was the co-location case and how it helped some of the stock brokers in India? **(5 Marks)**
2. How the committee formed by SEBI hope to bring ethical efficiency in the working of the Market Infrastructure Institutions (MIs) such as National Stock Exchange? **(5 Marks)**
3. Discuss with reference to the practical instances as to how the recent strengthening of rules relating to Market Infrastructure Institutions (MIs) will boost up the capital market in India. **(5 Marks)**
4. Multiple Choice Questions **(10 Marks)**
 - (i) Which among the following is not a Market Infrastructure Institutions (MIs)?
 - (a) Stock Exchange
 - (b) Foreign Institutional Investors
 - (c) Depositories
 - (d) Custodians
 - (ii) A maximum of period were authorized by the MD of an exchange.
 - (a) two five-year
 - (b) one five-year
 - (c) two ten-year
 - (d) one ten-year
 - (iii) SEBI recommended that internal committees be reduced from in order to improve efficiency.
 - (a) fifteen to seven
 - (b) fifteen to ten
 - (c) ten to seven
 - (d) fifteen to twelve

- (iv) In case of public offer of Indian Depository Receipts, the issuer shall enter into an agreement with an overseas custodian bank and a
 - (a) overseas depository
 - (b) domestic depository
 - (c) domestic custodian
 - (d) none of the above
- (v) A rights issue shall be open for subscription in India for a period as applicable under the laws of its home country but in no case less than
 - (a) three days.
 - (b) five days.
 - (c) seven days.
 - (d) ten days.

CASE STUDY: 5

(a) The Securities and Exchange Board of India (SEBI) recently issued a new circular relating to the disclosure of information on the application form for initial public offerings (IPOs). This goes into effect immediately. While the salient information to be provided isn't subject to much alteration or addition, the regulator appears to be making a creditable effort to ensure this information is easily read and comprehensible. This is aimed at making life easier for retail investors, who often rely purely on the information given in the application form.

The market regulator has said a copy of the abridged prospectus must be made available on the website of the issuer, the lead managers, and the registrar to an issue. In addition, a link for downloading the abridged prospectus must be provided in the price band advertisement. This may be in the form of a QR code that can be scanned for easy download of the full prospectus and the abridged version.

Further, the information should be "adequate, accurate and not contain any misleading statement". The issuer should also ensure that any qualitative statement in the abridged prospectus are substantiated with key performance indicators (KPIs) and other quantitative factors. No qualitative statement must be made that cannot be substantiated with KPIs. In the circular, SEBI also said the front page of the application was often crowded and difficult to read due to a large amount of statutory information.

The circular includes an annexe, which illustrates by presenting a dummy prospectus what details should be listed and the format in which they should be presented. Under the revised format, a company will have to disclose the name of the promoter and the details of the offer to the public, the type of issue, fresh issue and the offer for sale (OFS) component, and total issue size and also share reservation details on the front page of the abridged prospectus.

Additionally, the following pages of the abridged prospectus must contain a general disclosure of risk; details about the promoters' relevant experience and education; the directors' experience and education; a brief overview of business strategies including revenue segmentation by product or service; geographical coverage of the firm; intellectual properties, if any; market share; employee strength; factory locations, etc.

Also, the segmentation of objects of the issue by the amount allocated, the shareholding pattern and, the consolidated financials must be mentioned. The top five risk factors as stated in the draft red herring prospectus (DRHP) must also be stated and any litigation or criminal actions against the promoters must be mentioned. All these details and more are listed in the DRHP and RHP, but those tend to be lengthy documents, which retail investors may lack the ability to comprehend. By ensuring that the above information is easily available in the application form and presented in a fixed template, the regulator will make it easier to comprehend.

The IPO market has seen a drop in sentiment after the deep correction in Paytm and several other newly listed companies. This comes after an extraordinary bull runs through 2021 when many companies raised

money at highly optimistic valuations. Investors are likely to be more cautious now, in the face of tightening liquidity. Transparent disclosure is likely to make their task of assessing IPO prospects better.

(b) The RBI's latest Monetary Policy Committee (MPC) meeting was set against the backdrop of an inflexion point in the global policy cycle. More and more central banks have begun either the tapering of the stimulus or talking hawkish and/or raising rates. This is more so with the underlying inflationary pressures, which are both staying more persistent, as well as at levels that are higher than earlier imagined.

India has not been an exception though we can quibble about the extent of the problem. Our CPI inflation averaged 6% over the last two years. While initially the bump up in inflation was on account of higher food prices, now it is led by fuel and core inflation, which have averaged 12.3% and 5.9% in FY22.

RBI has hence raised its inflation forecast but the raise is a little underwhelming. Though the estimate for Q3 has been raised to 5.1% from 4.5%, it has kept its overall forecast for FY22 at 5.3%. With wholesale or producer price inflation running in double digits, firms have little choice but to pass on higher prices to consumers in the coming months. In addition to this, recent price hikes by telecom firms and changes in the GST structure for the textile sector will also impart an inflationary impulse into the economy in the coming months. We expect inflation to be a bit higher at 5.4% in FY22.

On growth, the MPC has retained the estimate for FY22 at 9.5% with the RBI Governor emphasising the need to be cautious. With GDP growth already at 13.7% during the April-September period, we believe the actual outcome for FY22 is likely to be higher at 9.8% followed by an above trend growth of more than 8% for FY23 as well.

The above backdrop made a case for increasing the reverse repo from the current levels of 3.35%. Instead, the RBI again chose to increase the effective rate indirectly by announcing that it will increasingly absorb most of the surplus liquidity with the banking system through the variable rate reverse repo (VRRR) window in continuation with the path that it began last policy. RBI has said that it is looking at absorbing as much as ₹ 7.5 lakh crore through the variable rate window in end-December without any assurance on the amount that it will leave on the table daily.

Notably, overall liquidity absorption through overnight and VRRR window a few days ago was at ₹ 9.5 lakh crore. Out of this, absorption at the fixed window was at ₹ 2.3 lakh crore. This suggests the absorption under a fixed overnight rate may come down from ₹ 2-3 lakh crore indicated in the October 2021 policy.

What effect will this action have on short-term interest rates in January 2022? If the RBI begins to absorb the majority of liquidity through 1-day and 3-day auctions in addition to the existing 14-day and 28-day VRRR, overnight market trading rates will be closer to the repo rate. If the majority of the absorption is done through 14-day operations, however, overnight rates are unlikely to rise substantially since banks may prefer to keep some overnight liquidity to cover short-term liquidity mismatches.

On longer-term bonds, the initial reaction was for the 10-year yield to fall by less than 5 basis points. Fiscal policy will become considerably more essential if yields are to decline from here. In the following months, the government plans to spend an additional ₹ 2.99 lakh crore. While this is good for growth, and a lot of it will be paid by increasing tax revenues, we anticipate the nominal fiscal deficit will be bigger than the budget estimates. While the government may be able to stick to its deficit target in percentage terms because nominal GDP is expected to be higher than expected, this raises the potential of more borrowing in the coming months. As a result, the 10-year yield may remain in the range of 6.25-6.50 in the remaining months of FY22.

Finally, let's talk about currency. The dollar index has surged 7% this calendar year as global currency markets anticipate a monetary policy move that will make the US central bank significantly more hawkish than the rest. With rising oil prices and high non-oil imports, the rupee has also fallen by 3.2 percent, resulting in record trade deficits. With the US Federal Reserve looking to accelerate its rate hike cycle, as well as increasing trade deficits and equities outflows, the rupee could see additional devaluation.

Questions

Based on above, answer the following questions:

1. How does simplifying disclosures regarding abridged prospectus will help retail investors applying for an Initial Public Offer. **(5 Marks)**
2. Discuss the key disclosure requirements of a prospectus. **(4 Marks)**
3. The recent inflation trends made a case for reverse repo rate hike. But RBI chose to absorb liquidity indirectly through overnight and variable rate reverse repo (VRRR) window. Discuss the reasons behind RBI's intentions keeping the recent scenario in mind. **(6 Marks)**
4. Multiple Choice Questions **(10 Marks)**
 - (i) Which among the following is not a credit policy objective of RBI?
 - (a) Control inflation and maintain the stability of prices
 - (b) Achieving economic growth
 - (c) Maintaining exchange rate stability
 - (d) Maintaining capital market stability
 - (ii) An increase in interest rate
 - (a) increase the capitalized value of the firm's fixed assets
 - (b) reduce the company's cost of capital
 - (c) precipitate reduction in production
 - (d) precipitate increase in output
 - (iii) Maintenance of CRR and SLR are a part of what is known as the in Central Banking.
 - (a) Fractional Reserve System
 - (b) Liquidity Adjustment Facility
 - (c) Margin Standing Facility
 - (d) Market Stabilization Scheme
 - (iv) Which among the following is not true with regard to Federal Reserve System?
 - (a) Conducts the nation's monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy.
 - (b) Promotes the stability of the financial system and seeks to minimize and contain systematic risks through active monitoring and engagement in the U.S. and abroad.
 - (c) Promotes the safety and soundness of individual financial institutions and monitors their impact on the financial system as a whole.
 - (d) Promotes the soundness of the capital, money and foreign exchange market.
 - (v) is a prospectus/document which enables an issuer to make a series of issues within a period of 1 year without the need of filing a fresh prospectus every time.
 - (a) Placement document
 - (b) Shelf prospectus
 - (c) Abridged prospectus
 - (d) Red herring prospectus