

MOCK TEST PAPER
FINAL (NEW) 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

Vishika graduated from All India Commerce College in year 2017. She and her friend, Aradhya decided to on a trip to Sikkim before striving to enter into working world. They booked air tickets and third Thursday of December 2017, they were in Sikkim. They were very excited and thrilled. They visited various sights they had planned. They experienced local food and culture as well as bought some souvenirs for their near and dear ones.

It was Tuesday night and both Vishika and Aradhya were packing their stuff to return to Delhi next day. Aradhya felt very tired so she went to sleep after packing while Vishika continued. While sorting things in her handbag, Vishika found something - there were some fallen leaves she had collected on her sightseeing. Luckily she got a stamp pad on the hotel room study table. She pulled out a clean unruled sheet of paper from her travel journal and pressed fallen leaves soaked in stamp pad ink against it. Vishika was smiling wholeheartedly looking at the sheet for it was not just a sheet but a beautiful creation of art. She posted the art on Facebook and slept. Next morning, when she opened her Facebook page, all she could find was bounties of appreciation and some people even requested to buy her art. She showed it to Aradhya who too was moved by the beauty of the creation. The entire return journey was a discussion between the two friends and they landed Delhi with a decision to set up a business of personalised items using recycled materials.

Since then, it has been 5 years and they are proud owners of a firm, Vrikshya. Vrikshya has been getting bulk orders and generating handsome revenue. With an employee count of 100 under the leadership of Vishika and Aradhya, the firm has so far witnessed growth and profits.

It's May 2019. Both Vishika and Aradhya are studying firm MIS and they realise that as the business has expanded, they had less time available to focus on credit control. Collections from accounts receivable has deteriorated and despite high profits, firm is using more of overdraft facility to pay for business expenses that became due sooner than they get paid. They need cash flow to pay employees, vendors and cover other business expenses. At first, they decided to approach their bank for assistance.

Based on the firm performance record, the bank was ready to sanction a fund- based working capital limit of 2 crores and interest rate is Base Rate +2% p.a, payable at monthly basis.

However, somewhere in her mind, Aradhya was not convinced with idea of cash credit from bank and insisted to look for other alternatives. They referred a local firm specialising in credit management consultancy. It suggested that they either employ a credit admin or factor accounts receivable. Factoring was new to both Vishika and Aradhya. The local firm suggested Expert Associates to Vrikshya partners for factoring services. Expert Associates was known to provide factoring services involving advancing 80% of the receivables at 12% p.a. and 2% factoring commission.

While the discussion was going on, Vishika received a call from her team that Vrikshya has received an international order, big enough in terms of contribution to profits.

Questions:

Based on above, answer the following:

1. While discussing about factoring, the manager of the local firm specialising in credit management consultancy mentions:

“In factoring, the factor not only finance trade debts but also performs various other functions”. Justify this statement. **(5 Marks)**

2. Following information is available:

- Total credit sales of Vrikshya for last year were ₹ 6.40 crores and average collection period is 50 days. Sales are expected to increase by 20% over the next year.
- Employs a good credit admin would cost 13,00,000 per annum to the business. It is estimated that the average collection period can then be reduced to 45.
- Availing factoring services from Expert associates will reduce average collection period to 30.
- Current overdraft rates are 11% per annum.

You have to determine whether it is financially beneficial for Vrikshya to factor its accounts receivables for the next year, as compared to employing a credit admin. Assume that there are 360 days in a year.

(5 Marks)

3. Vrikshya received an international order, big enough in terms of contribution to profits. The factoring firm, Expert Associates, specialised in domestic factoring only. This led the firm partners to approach Global Associates, a firm specialising in international factoring services to understand factoring in context of international orders.

As a team member of the Global Associates, prepare a summary of the distinct advantages of factoring over other methods of finance/facilities provided to an exporter.

(5 Marks)

4. Multiple choice questions:

(10 Marks)

(i) Projected figures as per CMA report for Vrikshya are : sales of ₹ 8 crores, total current assets of ₹ 5 crores, and other current liabilities of ₹ 2 crores. In the light of this, which statement is correct, assuming no current bank borrowing?

- (a) The fund- based working capital limit of 20 lacs is in congruence with turnover method.
- (b) The fund- based working capital limit of 20 lacs is in congruence with Method 1 as per Maximum Permissible Banking Finance.
- (c) The fund- based working capital limit of 20 lacs is in congruence with Method 2 as per Maximum Permissible Banking Finance
- (d) None of the above.

(ii) Using the following figures, the gross working capital for Vrikshya is:

Trade receivables	40,00,000
Cash and cash equivalents	5,00,000
Trade Payables	14,00,000
Short term provisions	2,00,000
Short term borrowings	2,00,000

- (a) ₹ 31,00,000
- (b) ₹ 29,00,000
- (c) ₹ 27,00,000
- (d) ₹ 45,00,000

(iii) All the following statements are correct about two factor international factoring except?

- (a) The responsibilities relating to book- keeping and collection of debts remain vested with the import factor.

- (b) Import factor provides the credit protection in case of financial inability on the part of any of the debtors.
 - (c) Factoring commission is shared by export factor with import factor at mutually agreed rate.
 - (d) The export factor bases his credit decision on the financing standing of the availing bank.
- (iv) Another firm, Truefactor Financial Services agreed to factor Vrikshya receivables involving advance 80% of the receivables at 10% p.a. and 2% factoring commission. Following information is available:
- Annual credit sales 1.2 crore and average collection period 50 days
 - The past experience indicates that bad debt losses are around 2% of credit sales
 - The factoring is expected to save 50,000 in administration costs and also to eliminate all bad debt losses.
 - Assume 365 days in a year
- The amount remitted to Vrikshya is:
- (a) 12,82,192
 - (b) 13,15,068
 - (c) 12,64,628
 - (d) 11,53,973
- (v) Net factoring cost in case of Truefactor Financial Services above is:
- (a) 5.95%
 - (b) 6.19%
 - (c) (18.94)%
 - (d) (2.56)%

CASE STUDY: 2

Aditya is a credit rating analyst with FAIR Ratings, a reputed credit rating agency in India. FAIR Ratings not only provides grading and rating services but also conducts analytical studies and surveys on the economy, money market and corporate performances. The manager of Aditya asked Aditya to study ABC India Limited and gather relevant information.

ABC India Limited is an Indian banking and financial services company headquartered in Mumbai. As of March 31, 2019, the Bank's distribution network was at 500 branches across 264 cities.

Business

The bank is divided into two divisions:

The Consumer Bank

This division is retail-focused and the clients served are individuals and small businesses. The product offered by this division include advances, deposits, mortgages, personal loans, wealth management services, trade credit, business finance and cash management services. The Bank recorded 23% growth in the retail deposits in the previous year.

The Wholesale Bank

The wholesale bank's clients are large corporations, government and financial institutions. The products and services include working capital and term Loans as well as trade credit, cash management, supply chain financing, foreign exchange, and investment banking services. The Wholesale Banking business recorded a healthy 29% percent growth.

Risk Architecture of the bank

The key risks that the Bank is broadly exposed to in the course of its business are Credit Risk, Liquidity Risk, Market Risk, and Operational Risk. The Board of Directors assumes the oversight responsibility for all the risks assumed by the Bank and specific Board Committees have been constituted to facilitate focussed risk management. The Board has in place approved Risk Strategy and Policies whose implementation is supervised by the Risk Management Committee. The committee periodically reviews the risk levels and ensures timely action for the risk identified.

Credit Risk

Credit Risk is defined as the possibility of losses associated with diminution in the credit quality of borrowers or counter parties. Losses stem from outright default or reduction in portfolio value. The Bank has sufficient policies, procedures and systems for managing credit risk in both its retail and wholesale businesses.

Given the granularity of individual exposures, risk management in Retail business is largely on a portfolio basis across various products and customer segments. The factors considered while sanctioning retail loans include income, demographics, credit history of the borrower and the tenure of the loan.

Risk in Wholesale business is managed on an individual as well as portfolio basis. Credit risk is managed by capping exposures on the basis of borrower group, industry, credit rating grades and country amongst others. This is backed by portfolio diversification, stringent credit approval processes and periodic post-disbursement monitoring and remedial measures.

Market and Liquidity risk

Market risk stems from the movement in interest rates, foreign exchange rates, credit spreads and equity prices. Liquidity Risk is the risk that a bank may not be able to meet its short term financial obligations due to an asset– liability mismatch or interest rate fluctuations. The bank is structurally exposed to market risks and liquidity risks because of statutory liquidity ratio requirement as well as capital and liquidity requirements. These risks are managed through a well-defined Board approved Investment Policy, Asset Liability Management Policy and Market Risk Policy. The risk measures include position limits, gap limits, tenor restrictions and sensitivity limits.

Operational Risk

This is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This could include fraud or other misconduct by employees or outsiders, unauthorised transactions by employees and third parties, misreporting or non-reporting with respect to statutory, legal or regulatory reporting and disclosure obligations, operational errors including clerical and record keeping and system failures. To manage operational risks, the Bank has put in place a system of internal controls, systems and procedures to monitor transactions, key back-up procedures and undertakes regular contingency planning. The governance and framework for managing operational risks is defined in the Operational Risk Management Policy.

Recent developments

1. The bank announced the launch of its first Collateralized Loan Obligation.

The bank pooled 80% of its institutional loan and assigned all the future receivables from them to a SPV as collateral. The institutional loans, represent ₹ 450 crores bank loans to 10 companies from various sectors with existing track record of repayment and average residual maturity of about 3 years. The SPV here is close-ended debt scheme under the PQR Securities Fund, a mutual fund registered with SEBI. The Scheme offers three classes of units:

- The Class A units (senior tranche) representing 60% of collateral, being offered for investment are rated AAA(SO) by CARE. The Class A units will be offered to institutional investors through the book-building process.

- The Class B units (Mezzanine tranche) representing 25%, are rated A+ (SO) by CARE and would be subscribed by the XYZ Bank subject to regulatory approvals. Class B is subordinate to Class A.
 - The Class C units (equity tranche) representing 15%, unrated would be subscribed by PQR. Class C is subordinate to both Class A and Class B.
 - Under the Scheme, each unit will have a face value of ₹ 50 lacs with a minimum investment of ₹ 2 crore.
2. The bank has a 10-year, unsecured, 8% bond of DEF Limited with ₹ 10 crores par value. Last year, the credit rating of the bond was downgraded to BB. Discussion is going on between ABC Bank Limited and MNC Bank to buy a credit default swap.
 3. The bank is considering purchasing a bond issued by Government of Nigeria.
- Aditya prepared a report on his findings and mailed it to his manager. Next day, his manager called a meeting to have a discussion with Aditya on his report.

Questions:

Based on above, answer the following:

1. In his report, Aditya mentions, "Just like other financial products, Collateralized Loan Obligations (CLO) are also subject to various types of risk." What do you think which risks Aditya is talking about? Explain. **(5 Marks)**
2. Structure a credit default swap between ABC Bank Limited and MNC bank. **(4 Marks)**
3. Aditya commented that ABC Bank Limited is subject to credit risk of 10 year, unsecured 8% bond of DEF Limited. The manager asked him to categorise the risk for better credit analysis. You are required to help Aditya to determine the categories of the credit risk with respect to the aforesaid bond. **(6 Marks)**
4. Multiple choice questions: **(10 Marks)**
 - (i) Aditya performed a financial analysis of ABC Bank Limited and few other banks using the CAMEL framework. Banks were ranked as follows:

Bank	C	A	M	E	L	Average	Rank
ABC Bank Limited	1	2	2	1	2.5	1.7	1
JKL Bank	3	1	4	4	1	2.6	3
NGO Bank	2	4	1	3	2.5	2.5	2
TMG Bank	4	3	3	2	3	3	4

In the light of above, which statement is correct?

- (a) ABC Bank scores highest in terms of Credit worthiness.
 - (b) JKL Bank scores lowest in Employment Level.
 - (c) NGO Bank scores par with ABC in Leverage.
 - (d) TMG Bank scores higher than NGO Bank in Asset quality.
- (ii) Aditya noted that the CLO launched by ABC Limited is a form of Cashflow CDO. It differs from a Synthetic CDO. Which statement is correct for unfunded synthetic CDO?
 - (a) Unfunded synthetic CDO comprises of Credit Linked Notes (CLN) only.
 - (b) Unfunded synthetic CDO comprises of Credit Default Swap (CDS) only.
 - (c) Unfunded synthetic CDO comprises partially Credit Default Swap and partially CLN.

- (d) None of the above.
- (iii) While studying the annual report, Aditya noted that the ABC bank has originated on an average ₹ 1500 crores of home loans last year.
- Following are the details pertaining to one such home loan advanced by ABC Bank:
- Original Home Value ₹ 1.2 crore, Loan to Value 80%, Home Loan ₹96 lakhs
 - Outstanding loan 90 lacs, Current home value ₹ 84 lacs,
 - Probability of Default 50%.
- The recovery rate and expected loss on home loan is:
- (a) 87.5% and ₹ 6,00,000
- (b) 70% and ₹ 3,00,000
- (c) 93.33% and ₹ 3,00,000
- (d) 100% and ₹ 12,00,000
- (iv) Which of the following statement is correct with respect to Credit Default Swap (CDS) on 10 year unsecured 8% corporate bond of DEF Limited?
- (a) In case a Credit Default Swap (CDS) is entered into, the cost of CDS will be lower.
- (b) In case a Credit Default Swap (CDS) is entered into, it will be a naked CDS.
- (c) In case a Credit Default Swap (CDS) is entered into, credit risk will be eliminated.
- (d) In case a Credit Default Swap (CDS) is entered into, MNC Bank will make profit as long as DEF does not default on the bond.
- (v) Which of the following statements by Aditya about country risk in purchasing bond from Government of Nigeria is correct?
- (a) The bond carry liquidity risk as the Nigerian government may fail to make timely payments on the bond it issued or actually default on its bond obligations.
- (b) The bond carry exchange risk as bonds are priced in local currency and country may inflate their way out of debts by simply issuing more currency, making the debt less valuable.
- (c) The bond carry repricing risk as in case of distress, Nigerian government may renegotiate terms of the bond resulting in new bond value.
- (d) The bond carry transfer risk as in case of a political instability, change in regime could affect how well an interim or new government may pay its debt.

CASE STUDY: 3

Arogyam Healthcare is a leading healthcare services provider in India. The chain offers comprehensive, seamless and integrated world class treatment across various specialties through a network of 15 hospitals.

On November 12, Monday, the procurement department of the healthcare received a request for purchase of three fourth generation CT scan machines for the radiology facilities of the three hospitals. With an inclination towards "Made in India" products as well as based on positive reviews, the procurement department shortlisted "Techno ACT", SAGE indigenous CT scan system. The department contacted sales team of SAGE India for the scanner quotation.

On November 14, Vinay Sood, procurement manager of Arogyam received an e-mail from a sales executive of SAGE Sales department which read as:

"Dear Sir,

Thanks for your interest in our Techno ACT, a "Made in India" scan system. We are excited to hear from you.

In response to your query, the machine costs ₹ 1 crore per piece. We can offer you two customised alternatives:

You can pay 30 percent down and the remaining balance through loan from BDA Bank. BDA Bank offers financing on favourable terms to our customers. The loan is available at 10 percent interest with nine annual instalments of ₹ 12,15,484. Instalments are payable at the end of the year. The system can be used in the hospitals for twelve years, after which it can be sold for scrap for ₹ 5,00,000.

You can lease the same machine for twelve years at an annual rent of ₹ 12,10,000, the first payment of which is due on delivery. The lease is irrevocable. You will be responsible for the insurance and maintenance costs during the lease.

We can also arrange AMC from our preferred service provider for which annual maintenance costs comes out to ₹ 8,00,000.

We hope the information provided in it answers your query. However, please do not hesitate to contact us for further clarification if need be.

We look forward to your patronage.

Warmest Regards

Mrunal Das

Sales Executive, SAGE India"

Vinay approached ACE Bank to discuss financing of the scan system. From time to time, ACE Bank has been funding the working capital of Arogyam as well as providing term loans for purchasing medical equipments. For scanner, the ACE Bank was ready to provide term loan at 11% per annum repayable in ten equal instalments of ₹ 16,98,014.

To decide which alternative is best, Vinay forwarded the SAGE e-mail to Capital Budgeting team, together with ACE bank loan offer details for their evaluation on the most favourable alternative.

The team is headed by Pradeep Singh. Pradeep was then busy on a project financing assignment and the plain reading of mail convinced him that the evaluation requires some major calculations to be performed. So he assigned the task of evaluating the alternatives to Sudeep, an intern working under Pradeep on probation.

Two days later, Pradeep called Sudeep and asked him about his findings. Sudeep showed his calculations to Pradeep. An excerpt from Sudeep's working is presented below:

Year		Cost of machine	1,00,00,000	Scrap Value	5,00,000
	WDV at the beginning of the year	Depreciation for the year @40%	WDV at the end of year	Present Value factor @10%	Present Value factor@7.8%
	(A)	(B)=A*40%	(C)= A-B		
1	1,00,00,000	40,00,000	60,00,000	0.9091	0.9276
2	60,00,000	24,00,000	36,00,000	0.8264	0.8605
3	36,00,000	14,40,000	21,60,000	0.7513	0.7983
4	21,60,000	8,64,000	12,96,000	0.6830	0.7405
5	12,96,000	5,18,400	7,77,600	0.6209	0.6869
6	7,77,600	3,11,040	4,66,560	0.5645	0.6372
7	4,66,560	1,86,624	2,79,936	0.5132	0.5911
8	2,79,936	1,11,974	1,67,962	0.4665	0.5483

9	1,67,962	67,185	1,00,777	0.4241	0.5087
10	1,00,777	40,311	60,466	0.3855	0.4719
11	60,466	24,186	36,280	0.3505	0.4377
12	36,280	14,512	21,768	0.3186	0.4060
				6.8137	7.6148

Sudeep stated:

"The lease is an operating lease as the scan system does not get transferred to Arogyam at the end of lease. Also, as per Bower-Herringer-Williamson Method, the operating advantage of purchase exceeds that of leasing. These two suggest that buying the machine would be the correct decision "

Pradeep thoroughly reviewed the calculations. He remarked, *"The calculations are arithmetically correct but some aspects have been left out to support the evaluation."*

After analysing the case at his own level using the internal rate of return approach, he e-mailed procurement department:

"Based on our study, we conclude that it would be preferable to lease the scan system rather than buy it. The cost of leasing comes out to be less than the cost of borrowing and buying. By leasing, following advantages will accrue to the chain:

- *Leasing would avoid Arogyam's own capital being locked up, since it would be the lessor who would buy and own the equipment.*
- *Lease payments are tax deductible and hence score over borrowing.*
- *Further leasing is convenient in the sense it is similar to car rental."*

Questions:

Based on above, answer the following:

1. Sudeep stated that the lease offered by SAGE is an operating lease.
Based on the information provided, discuss whether Sudeep is correct or not. No calculations required. **(4 Marks)**
2. Discuss the soundness of advantages offered in advice by Pradeep. **(3 Marks)**
3. Vinay wanted to know if they can negotiate on the lease rental. So he asked Pradeep to determine the break even lease rental per machine for Arogyam. The cost of capital is 7.8%. Tax rate is 22%. Given that the system will constitute a separate block for depreciation purpose and depreciation is allowed @40% on reducing balance method, help Pradeep compute the before tax break even lease rental (BELR). **(8 Marks)**
4. Multiple choice questions: **(10 Marks)**
 - (i) If Arogyam decides to borrow money from ACE bank for one machine, the principal component repaid under second loan instalment will be:
 - (a) 7,36,813
 - (b) 16,98,014
 - (c) 6,63,796
 - (d) 10,34,218
 - (ii) Sudeep mentioned that as per Bower-Herringer-Williamson Method, the operating advantage of purchase exceeds that of lease. The financial advantage of leasing per machine is:
 - (a) 17,55,423

- (b) 9,30,929
 - (c) 67,352.
 - (d) 7,86,092.
- (iii) Which of the following statements is not correct?
- (a) Since lease rentals are tax deductible, operating leases offer tax benefits.
 - (b) By employing 'sale and lease back' arrangement, the lessee may overcome a financial crisis by immediately arranging cash resources for some emergent application or for working capital.
 - (c) In finance leases, the lessee is safeguarded against the risk of obsolescence.
 - (d) The lessor earns commission in addition to rentals under Sales-Aid- Lease
- (iv) Pradeep used internal rate of return approach to determine whether leasing is preferable. He started with 7% rate at which net present value of cash flows computed for IRR comes out to 2,14,703 while for 8% it comes out to 1,69,550. The IRR is close to:
- (a) 7.55%
 - (b) 7.44%
 - (c) 7.80%
 - (d) 8.78%
- (v) Incremental tax saving due to leasing over borrowing for year 12 is:
- (a) 3,76,200
 - (b) 3,65,026
 - (c) 3,73,007
 - (d) 3,68,218

CASE STUDY: 4

Three friends, Aman, Amar and Armaan, were meeting after a long time, enjoying coffee in Cafe Coffee Day. Aman is an IT consultant working with Tata Consultancy Services. Amar is a business man and runs a firm engaged in manufacturing and sale of toys. Armaan is a finance professional working with an investment firm.

The casual talk over coffee suddenly turned into discussion on mutual funds. Both Aman and Amar were looking forward for investment in mutual funds. Being inclined to equity schemes, Amar has been constantly gathering knowledge about Mid-cap funds and ELSS schemes while Aman was inclined to hybrid schemes.

Aman: "Amar, which category of scheme do you prefer?"

Amar: "I prefer equity schemes. They deliver highest returns. I am particularly interested in Mid-cap Funds and ELSS schemes. As far as I know, Mid-Cap funds are open ended schemes and invests 55% or more of total assets in stocks of companies ranked between 50 and 100 by full market capitalisation. On the other hand, ELSS schemes offer tax benefit with a lock-in period of 5 years. And you ??"

Aman : "To me, hybrid schemes are better. They invest equally in equity and debt instruments. A good example is Balanced Hybrid Fund. It allows arbitrage too. Amar, why don't you consider Equity Savings Scheme ? It is similar to ELSS Scheme. Armaan, which scheme do you like?"

Armaan: "'Well, there is no such perfect scheme. To select a particular mutual fund, we need to consider various factors such as past performance, PE ratio, expense ratio, size and age of fund etc."

Aman: "Fair enough. Armaan, I need some information. I heard in news about Kotak Nifty ETF. What exactly is an ETF? I heard Infrastructure Investment Trusts are like ETF in some sense. "

Armaan: "An ETF stands for Exchange Traded Fund. It is a basket of securities that reflects the composition of an Index, like Nifty 50. Investors can trade ETFs throughout the trading day. Well Infrastructure Investment Trusts, INVITs as they are called, are like ETF in some sense. But they are entirely a different concept...."

Armaan received a call from office in mid of discussion and had to leave immediately for an urgent work in office. The two friends continued their discussion.

Amar: "How about closed ended mutual fund schemes"?

Aman: "Frankly, I don't know much about them. From hearsay, I know that unlike open ended schemes, they do not imply corpus size volatility for AMC."

Amar: "Hmmm.. "

Aman: "Hey, I just recall, the company where my wife Ananya works, Techvision has issued Commercial Paper and it is currently open for subscription. Do you think I should invest in it?"

Amar: "Yes, you should. I too had invested before in a Commercial Paper few years ago. Why? Firstly, Commercial paper is freely negotiable just like a commercial bill. You know, I am in a business line. Daily, we have many transactions on credit. We draw bills of exchange and get them discounted. Similarly, you can endorse and deliver CP. Secondly, you can match your cash flow requirements. CP are generally issued for periods ranging from 15 days to one year. Only problem is that issuer has to pay higher stamp duty on CP if issued for a shorter period. Thirdly, CP are issued by high rated corporate entities and are secured. They are therefore safe investments. Lastly, the investment is quite liquid."

Aman: "That's sounds convincing."

While the two friends were still discussing, Armaan was called upon by his manager, Raman.

Raman: "Armaan, we have been approached by Mr. Ramen. Mr Ramen, if you remember, aged 52 years, is our client with investment on mutual funds side. He is now looking for Government securities in money market that offer inflation linked returns. You contact Mr Ramen and advise him about such securities."

Armaan: "Sure Sir."

Raman: "Also, prepare a presentation on money market mutual funds. Refer RBI site for regulatory framework. We need this presentation for technical learning session."

Armaan: " Ok Sir, In case of any problem, I will approach you

Based on above, answer the following:

Questions:

1. Discuss the soundness of the statements made by Aman and Amar with respect to their preference for mutual fund schemes. **(6 Marks)**
2. Discuss whether Aman is correct as regards to :
 - (a) Corpus size volatility in case of close ended schemes.
 - (b) Infrastructure Investment Trusts. **(5 Marks)**
3. Which securities do you think will Armaan suggest to Mr. Ramen. Enumerate their salient characteristics. **(4 Marks)**
4. Multiple choice questions: **(10 Marks)**
 - (i) Based on advice from Armaan, Aman collected data for two mid-cap mutual funds ABC and XYZ from their annual reports for the financial year ended March 31, 2020:

Expenses	ABC Fund	XYZ Fund
Management fee	1,50,00,000	1,60,00,000

Trustee fees	12,00,000	10,00,000
GST on management fee and Trustee fees	29,16,000	30,60,000
Custodian service charges	18,00,000	21,00,000
Registrar Service Charges	6,00,000	5,50,000
Auditor's remuneration	6,74,485	7,86,453
Brokerage expense	40,97,740	38,75,497
Commission to distributors	82,14,723	75,64,219
Other operating expenses	2,38,564	3,92,137
Total	3,47,41,512	3,53,28,306
Net assets	ABC Fund	XYZ Fund
At 01/04/2019	80,42,10,196	81,50,90,257
At 31/03/2020	1,01,64,96,712	1,01,74,36,911

Expense ratio of a similar fund DEF is 3.33

In the light of above, which statement is correct in terms of expense ratio?

- (a) If ABC had assets equal to XYZ, ABC would have underperformed XYZ.
 - (b) If XYZ had assets equal to ABC, XYZ would have outperformed ABC.
 - (c) DEF outperforms both ABC and XYZ.
 - (d) All of the above.
- (ii) Continuing his evaluation, Aman computed following statistical ratios to look at point to point returns:

Ratio	ABC Fund	XYZ Fund
Sharpe Ratio	0.54	0.58
Sortino Ratio	0.81	0.42
Jensen Alpha	0.40	-0.04
Annualised Return	7.50	7.36

Risk free rate is 5%. Market return is 8%. Which of the following conclusions by Aman is not correct?

- (a) Negative volatility of XYZ returns exceeds its total volatility.
 - (b) If the annualised return of both ABC and XYZ is equal, total return variability is higher in case of ABC.
 - (c) ABC fund is more suitable for investment in terms of Treynor ratio.
 - (d) Systematic risk is higher in case of ABC fund.
- (iii) Which of the following statements of Amar as to Commercial Paper is incorrect?
- (a) Statement 1.
 - (b) Statement 2.
 - (c) Statement 3.
 - (d) Statement 4.

- (iv) Aman was curious to know more about ETF and INVITs. He dropped a message to Armaan seeking information about them. Armaan replied on email. Based on his reply, Aman called upon an AMFI Agent and asked to suggest ETFs and INVITs for investment. Which statements by AMFI agent is correct?
- (a) "There are many options available for ETFs. They allow investors to have exposure to index similar to futures. You can directly buy ETF units on NSE F&O Segment."
 - (b) "You can invest in INVITs provided you meet the minimum investment amount requirements of SEBI. Why don't you invest in REITs? Just like INVITs, REITs invest in infrastructure assets."
 - (c) "The performance of PSR Realty Fund has been really impressive.
PSR Realty fund is a real estate mutual fund. It invests in securities of companies having investments in properties. This way, it is similar to a REIT or INVIT. "
 - (d) If you looking for ETF, you can think considering closed ended mutual funds also. Similar to ETF, Closed ended funds trade on exchange intraday.
- (v) In his presentation, Armaan made following statements about money market mutual funds. Which of the following statements, do you think, will be only be accepted by his manager, Raman?
- (a) Money Market Mutual Funds are closed ended debt schemes set up specifically for the purpose of mobilisation of short-term funds. The resources mobilised by MMMFs are invested exclusively in various money market instruments having maturity upto 1 year such as Treasury bills, Commercial Paper, call money, etc.
 - (b) Money market mutual fund provides principal preservation while yielding a high return. They are generally the safest and most secure of mutual fund investments. Akin to a high-yield bank account, they are entirely risk free.
 - (c) Money market mutual funds offer the advantage of high liquidity, expertise of a professional fund manager, access to capital markets and diversification of short term assets.
 - (d) Money market mutual funds set up by banks are subject to reserve requirements as these funds are invested in money market instruments

CASE STUDY: 5

ABC Ltd., a company involved in precision engineering was incorporated on August, 1993 at Bangalore. Mayank Gehrotra is the CEO & Managing Director of the company. ABC Ltd. designs and builds highly engineered products for Automation and Aerospace. With its impeccable design, engineering and manufacturing facilities in America, Europe and India, the company is able to meet customers' requirements in many countries. ABC Ltd. has 1000 employees across all of its locations. There are 50 companies in the ABC Ltd. corporate family.

Everything was going well in the company. However, in a surprising development capital market regulator ordered the impounding of about Rs 5 crore from ABC Ltd. Managing Director and CEO Mayank Gehrotra in an insider trading case.

The reason for this impounding order was that a sum of Rs. 5 crore being the notional loss avoided on account of trades carried out during the period when the price sensitive information is unpublished. The watchdog had conducted an investigation into possible insider trading in the shares of ABC Ltd. during the period from August-November 2018.

During the probe, it was found that Gehrotra, being the CEO and Managing Director of ABC Ltd., had traded the company's shares while being in possession of UPSI (Unpublished Price Sensitive Information).

It was observed that the consolidated quarterly financial results of ABC Ltd. were communicated to the stock exchanges after the trading hours on November 11, 2016, and ABC shares fell on the immediate succeeding trading day on November 15, 2016.

It was also alleged that Gehrotra, having traded on the basis of UPSI, avoided loss on account of fall in price of shares due to the announcement of the said quarterly consolidated financial results of ABC. Therefore, the amount of loss avoided by Gehrotra in aggregate, including interest through trading in shares of ABC, amounted to over Rs 5 crore.

It was, prima facie, observed that the pre-trading approval was not taken for the required number of shares for which sale order was placed. Further, a designated person shall not apply for pre-clearance of any proposed trade if such person is in possession of UPSI even if the trading window is open, the watchdog said in its order.

Since Gehrotra was the managing director and 'a connected person', prima facie, he violated the provisions of PIT (Prohibition of Insider Trading) Regulations, the order said. In view of the above, it can be said that Gehrotra engaged in insider trading, which helped him to avoid loss due to a fall in stock prices of the company after its consolidated quarterly report was published.

Insider trading takes place when the buyer happens to have additional information about stock performance that is not available to the general public. It can be both legal and illegal, depending on when the trade is taking place. It is deemed unethical when trading happens when the information is still private, tilting the trade in favour of one party. These types of trading come with harsh consequences and may attract penalty from regulators. SEBI being the regulator keeps close monitoring to track such trades to prevent few traders from manipulating the market.

In the case of ABC Ltd., the regulator was investigating a case from 2016. It introduced the Prohibition of Insider Trading in 2015, which clearly states that insider trading is an unethical practice resorted by those in possession of certain unpublished information relating to a company to profit against general investors who don't have access to such information. It has listed the following people in its monitoring list in connection with any insider trading activity:

- Directors of the company
- Key personnel in Managerial positions
- People in the positions of Vice Presidents, General Managers, Dy. General Managers, Asst. General Managers
- Employees who have access to sensitive financial information/documents. All employees from Finance, Legal & Company Secretarial, HR & IT departments irrespective of grade will come under monitoring.
- All Personal Assistants and Secretaries to the Directors and Other Senior Officials
- Dependents of all the employees of the above categories

Impounding order by SEBI in insider trading case is announced against MD and CEO of ABC Ltd. as per the above list of people. It suggests that he used the UPSI knowledge to trade stocks to avoid a loss that occurred the following day when stock prices toppled after company's performance report was published.

On November 11 2016, company's financial performance report was shared with the exchange after trading hours, following which stock prices of ABC shares tumbled on November 15. In the case of ABC CEO, no pre-trading approval was taken, which led to the inquiry and subsequent seizing order for ABC Ltd.

Brief financials of the company

NAME	MARCH-20	MARCH-19	MARCH-18	MARCH-17	MARCH-16
Assets	781.05	1,017.61	1,032.33	1,008.91	580.01
Liabilities	781.05	1,017.61	1,032.33	1,008.91	580.01
Equity	6.34	6.34	6.34	6.34	6.34
Gross Profit	142.56	133.41	98.50	97.20	74.30
Net Profit	-207.74	32.30	3.79	15.32	1.29
Cash From Operating Activities	114.84	86.72	53.72	51.58	0.00
NPM (%)	-36.46	5.45	0.78	3.03	0.29
Revenue	569.63	592.15	483.92	505.03	431.37
Expenses	427.07	458.74	385.42	407.83	357.07
ROE (%)	-55.67	8.65	1.01	4.10	0.34

Shareholding Summary for ABC Ltd.

Type	Holding
Promoter	48.8
MF	10.6
FII	14.4
Public	26.1

Descriptive Questions

- 5.1 What were the charges leveled against the MD and CEO of ABC Ltd.? Were the charges tenable? Explain briefly. **(5 Marks)**
- 5.2 How could have Mayank Gehrotra avoid being implicated in the insider trading case? Discuss with reference to SEBI (Prohibition of Insider Trading) Regulations, 2015 **(5 Marks)**
- 5.3 Is there any obligation imposed on the CEO and the MD under the SEBI (Prohibition of Insider Trading) Regulations, 2015? If yes, then explain briefly with the help of the SEBI Regulations. **(5 Marks)**

Multiple Choice Questions**Choose the most appropriate answer**

- 5.4 It was alleged that Gehrotra, having traded on the basis of UPSI, ... on account of fall in price of shares due to the announcement of the said quarterly consolidated financial results of ABC.
- avoided loss
 - made loss
 - avoided profit
 - None of the above
- 5.5 A shall not apply for pre-clearance of any proposed trade if such person is in possession of UPSI even if the trading window is open.
- CEO
 - MD
 - Chairman

- (d) Designated Person
- 5.6 The reason Mayank Gehrotra violated the provisions of SEBI (Prohibition of Insider Trading) Regulations, 2015 was
- (a) Delayed pre-trading approval was taken for the required number of shares for which the sale order was placed.
 - (b) Pre-trading approval was not taken for the required number of shares for which the sale order was placed.
 - (c) Post-trading approval was taken for the required number of shares for which the sale order was placed.
 - (d) No approval was taken at all for the required number of shares for which the sale order was placed.
- 5.7 Which among the following is not a connected person as per the SEBI (Prohibition of Insider Trading) Regulations, 2015?
- (a) a holding company
 - (b) an investment company
 - (c) a best friend
 - (d) an official of a stock exchange
- 5.8 An insider who is continuously in possession of unpublished price sensitive information is entitled to formulate a trading plan and present it to the for approval.
- (a) Stock Exchange
 - (b) SEBI
 - (c) Compliance Officer
 - (d) Audit Committee
- (5 x 2 = 10 Marks)**