GCEM

INVESTMENT BANKING
&
FINANCIAL SERVICES

14MBA FM302

2016

G O P A L AN C O L L E G E O F E N G I N E ERI N G A N D
MA N A G EME N T

Module 1:
Investment Banking-

Introduction-

Functions of Investment Banks - Types of Investment Banks-Investment Banking Services - Merchant Banking Services-Issue Management-Pre issue and Post issue obligations-Changing landscape of Investment Banking Regulation of the Capital Market- SEBI regulations for merchant bankers, brokers and sub brokers, intermediaries and portfolio managers- SEBI issue and Listing of Debt securities Regulation 2008.

An **investment bank** is a financial institution that assists individuals, corporations, and governments in raising financial capital by underwriting or acting as the client's agent in the Assurance of Securities (or both).

Functions of Investment Banks

a. Core Business
- Underwriting
- Distributing
- Advising
- Others

b. Back Office
- Operations
- Technology

c. Middle Office
- Risk Management
- Corporate Treasury
- Financial Control
- Corporate Strategy
- Compliance

d. Core Business - Underwriting
- Assuming the risk of selling a security issue at a satisfactory price
- Term borrowed from insurance

e. Core Business - Distributing
- Selling function of investment banking
- The primary function of an investment bank is buying and selling products.

f. Core Business - Advising
- Providing advice in the issuance & marketing of securities
- Research is the division which reviews companies and writes reports about their prospects, often with "buy" or "sell" ratings.

g. Core Business > Others
- Global transaction banking
- Investment management
- Merchant banking
- Middle Office

- **Risk Management:** Involves analyzing the market and credit risk that traders are taking onto the balance sheet in conducting their daily trades. Setting limits on the amount of capital that they are able to trade in order to prevent 'bad' trades having a detrimental effect to a desk overall.

- **Corporate Treasury:** Responsible for an investment bank's funding, capital structure management, and liquidity risk monitoring.
- **Financial Control:** Tracks and analyzes the capital flows of the firm. Adviser on essential areas such as controlling the firm's global risk exposure and the profitability and structure of the firm's various businesses.
- **Compliance**: Responsible for an investment bank's daily operations' compliance with government regulations and internal regulations.
- **Operations & Technology:** Data-checking trades that have been conducted, ensuring that they are not erroneous, and transacting the required transfers.

Types of Investment Banks

There are two major types of investment banks based on their function. This might be more Relevantly referred to as branches of operation in investment banking.

1. **Sell side:** that includes functions such as trading securities and includes the facilitation oftransactions through market-making, and the promotion and marketing of securities throughresearch and underwriting.
2. **Buy side:** refers to institutions that give guidance and advice as it pertains to buying investmentservices. Common entities on the buy side include insurance companies, hedge funds, unit trusts,mutual funds and private equity funds.

Private or boutique investment banks: are concerned with private and confidential information and transactions that might not be revealed to the public. They are usually smaller banking entities that specialize in one or more areas of investment products. Others in this sector focustheir services on one type or one specific group of industries. These private entities carry out avariety of functions. Some may act as investment advisors while others specialize in the trade ofcertain assets and commodities. There are also those that offer services to specific social groupsand industries. Examples of private investment banks include; Almeida Capital, Atlantic-PacificCapital, J.P. Morgan Cazenove, Triago, China International Capital Corporation and CITICSecurities.

Public, Full-service or Bulge bracket investment banks: enlist a wider variety of marketactivities that include research, underwriting, mergers and acquisitions, trading, merchant banking, investment management and securities trading services. These bulge bracket banks areenormous investment institutions that cover all or most industries. They serve a wide variety ofclient types and offer most if not all possible types of investment banking services in theirportfolio. Major institutions that fall under this umbrella today are Bank of America Merrill Lynch, Barclays Capital, Citigroup, JPMorgan Chase and Morgan Stanley.

Investment Banking Services

Corporate Financial & Advisory: The management and underwriting of public and privatesecurities. Identification of investors for new ventures or for the expansion of establishedbusiness. Handling of public and private companies mergers, acquisitions and restructuring.Undertaking of industry research or project feasibility studies. Undertaking of share valuations for various purposes. Private placements of debt and equity.

Underwriting - Guarantee that all the issued shares will be sold. If there is any portion that is unsold, the underwriting institutions themselves will take it up.

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Portfolio and Investment Services: Nominee and registration services including custodianshipof all types of securities. Trading of stocks, shares, Government bonds and money marketsecurities. Management of corporate and private portfolio, trusts and pension funds. Shareregister and share registration services. Management of investment portfolios. Management ofinvestment and unit trusts and property trust funds. Fund management funds.

Corporate Banking: Management of syndicated and consortium facilities in local and foreigncurrencies. Provision of trade financing facilities. Syndication and provision of guaranteefacilities. Management and underwriting of commercial papers. Provision and arrangement ofshort, medium and long-term loans in Malaysia and overseas. Provision of bridging finance andproject finance. Provision of factoring and leasing facilities. Capital market issues. Blockdiscounting of hire-purchase agreements.

Syndicated Loan: When the value of loan required by a company is too large, it is possible that the company may be unable to obtain it from one single financial institution. Investment bank will help to arrange the loan from several financial institutions. Such loans are called syndicated loan. The aim of the syndicated loan is to reduce risks and exposure of each of the syndicate participants.

Fund-Based Activities: Acceptance of call and fixed deposits. Term loans Investment banks also offer a number of other services which are provided by commercial banks. Investment banks cannot accept current or demand deposits.

Services of Merchant Banking

- Corporate Counseling
- Project Counseling
- Capital Restructuring Services
- Credit Syndication
- Issue Management and Underwriting
- Portfolio Management
- Working capital Finance
- Merger and Acquisition
- Venture Financing
- Lease financing
- Mutual Finance
- Relief to sick Industries
- Project Appraisal
- SEBI Guidelines for Merchant Banking
- All merchant bankers will require authorization by SEBI to carry out business.
- An initial authorization fee, an annual fee and renewal fee may be collected by SEBI.
- All issue must be managed at least by on authorized banker.
- Each merchant banker is required to furnish to the SEBI half yearly unaudited financial result.
- SEBI has prescribed the code of conduct for the each merchant banker.
- SEBI has the power to suspend or cancel the authorization in case of violation.
- To ensure the transference and accountability in operation of the merchant banker and protect the investors.
- Inspections will be conducted by SEBI to ensure that provisions of the regulation are properly complied.

Issue management

Issue management involves marketing of corporate securities, like equity share, preference shares and debentures or bonds by offsetting them to public. Merchant banks act as intermediary whose main jobs are to transfer capital from those who own it to those who need it.

Equity issues

Equity issue otherwise known as Public issue or Initial public Offering. It is a marketable of securities to general public. Under this method, the issuing company directly offers to the general public or institutions a fixed number of shares at a stated price through a document called prospectus. This is the most common method followed by joint stock companies to raise capital through the issue of security.

Principal steps of a Public Issue

Public issue, as already stated refers to the issue of new share to the public. The new shares or debentures may be offered either directly to the public through a prospectus (offer document)or indirectly through an offer for sale involving financial intermediaries or issuing houses.

The main steps involved in public issue are the following:

i) Draft prospectus

A draft prospectus is prepared giving all details as mentioned earlier. Any company or a listed company making a public issue or a right issue of value of more than Rs.50, 00,000 has to file a draft offer document with SEBI for its observation. The company can proceed further only after getting observations from the SEBI. The company has to open its issue within three months from the date of SEBI‟s observation letter.

ii) Fulfillment of entry norms (EN)

SEBI has laid down certain parameters for accessing the primary market. If a company fulfills these parameters (EN), then only it can enter into the primary market.

Entry norms I

- The company should have net tangible Assets of atleast Rs.3 crore for three full years.
- It should have distributed profits in atleast three years.
- It should posses‟ Net worth of atleast Rs.1 crore in 3 years.
- If it has to change its name, atleast 50% revenue for the proceeding one year should be From the new activity.
- The issue size should not exceed 5 times the pre-issue net worth.
- To ensure that genuine companies doesn‟t suffer due to the rigidity of those parameters.
- The SEBI has laid done two more alternative routes for accessing the primary market.

Entry Norm II

- If the issue through book building route, at least 50% of the issue should be allotted to
- qualified institutional buyers (QIBs)
- The minimum post-issue face value capital shall be Rs.10 crore or there shall be a
- Compulsory market making for atleast two years.
- **Entry Norm III**
- If a company can ' t satisfy the requirements laid down under Entry Norm II, it can enter
- into the primary market through EN III route:
- The EN III requires the following
- The company should have atleast 1000 prospective allottees.
- The project should be appraised and participated to the extent of 15% by financial
- institutions and scheduled commercial banks of which atleast 10% comes from the Appraisers
- The minimum post-issue face value capital shall be Rs.10 crore or there shall be a compulsory market making for atleast 2 years.
- The above entry norms are not applicable to private and public sector banks, listed companies
- right issue and an infrastructure company whose project has been appraised by a financial
- institution or a bank and not less than 5% of the cost is financed by these institutions.

iii) Appointment of underwriters

Underwriters are appointed to shoulder the liability and subscribe to the shortfall in case the issue is under subscribed. For this commitment they are entitled to get a maximum commission of 2.5% on the amount undertaken.

iv) Appointment of banker

Generally the company nominates its own banker to act as collecting agent. The banker‟s along with their branch network act as collecting agencies and process the funds procured during the public issue.

v) Initiating Allotment Procedure

The next step is that the registrars process the application forms, tabulate the amounts collected during the issue and initiate the allotment procedures. The allotment procedure can be initiated only when the issue is subscribed to the minimum level.

vi) Brokers to the issue
Then recognized members of the stock exchanges are appointed as brokers to the issue for marketing the issue. They are eligible for a maximum brokerage of 1.5%
vii) Filling of documents: The draft prospectus along with the copies of the agreements entered into with the lead manager, underwriter, banker, registrars and brokers to the issue have to be filed with the registrar of companies of the state where the registered office of the company is located.
viii) Printing of Prospectus and Application forms
After filling the above documents, the prospectus and application forms are printed and dispatched to all merchant bankers, underwriters and brokers to the issue.
ix) Listing the issue
It is essential to send a letter to the stock Exchange concerned where the issue is proposed to be listed giving all necessary details and stating the intention of getting the shares listed on the stock exchange. The initial listing application has to be sent with a fee of Rs. 7,500.
x) Publication in Newspapers
The next step is to publish an abridged version of the prospectus and the issue‟s commencing andclosing dates in major English dailies and vernacular newspapers.
xi) Allotment of shares
After the close of the public issue all application forms are scrutinized, tabulated and then shares are allotted against those applications received.
xii) Underwriters Liability
In case, the issue is not fully subscribed, then the liability for the subscription to the extent of under subscription falls on the shoulders of underwriters who have to subscribe to the shortfall.
SEBI guidelines for equity issue

- Disclose to be made in the prospectus
- Company profile
- Pricing of issue
- Promoters contribution
- Issue of convertible
- Proportionate allotment of shares
- Firm allotment to mutual funds, foreign institutional investors and financial institution
- Underwriting has been made mandatory
- The collection center and collection agencies.

Pre issue and Post issue obligations
Pre-Issue Obligations

- Documents to be submitted along with Offer Document by the Lead Manager
- MOU
- Inter-se Allocation of Responsibilities
- Diligence Certificate
- Certificates signed by Company Secretary or Chartered Accountant
- List of Promoters‟ Group & other details
- Promoter individual shareholding.
- Stock exchanges on which securities proposed to be listed, Permanent A/c No.,
- Bank A/c No. & passport No. of promoters.

Undertaking to SEBI

- By „promoter‟, „promoter group‟ & relatives of „promoters‟ b/w date of filling offer documents & date of closure of issue.
- Appointment of Intermediaries
- Merchant Banker not lead manage issue:
- If he is a promoter or a director of issuer company.
- Can manage if securities listed/proposed to be listed on OTCEI.
- Merchant Banker lead manage issue:
- Associate of Issuer Company.
- Involved in marketing of issue.

Underwriting: The lead merchant banker shall satisfy themselves about the ability of the underwriters to discharge their underwriting obligations. The lead merchant banker shall:

- Incorporate a statement in the offer document to the effect that in the opinion of the lead merchant banker, the underwriters ‟ assets are adequate to meet their underwriting obligations.
- Obtain the underwriters written consent before including their names as underwriter's inthe final offer document. In respect of every underwritten issue, the lead merchant bankershall undertake a minimum underwriting obligation of 5% of the total underwritingcommitment or Rs. 25 Lakhs, whichever is less .Offer document to be made public the draft offer document filed with the SEBI shall be made public for a period of 21 days, from the date of filing the offer document with the SEBI.

The lead merchant banker shall:

1. While filing the draft- offer document with the board can also file the draft offer document with the stock exchange.
2. While filing the copy of the red-herring prospectus, prospectus or letter of offer , as thecae may be , with the board, can also file the copy of red herring prospectus , prospectus with the stock exchange.
3. Make copies of the draft offer-document available to the public and final-offer documents on the websites of all the lead managers associated with the issue No complaint certificate After a period of 21 days from the date the draft offer document was made public , the lead merchant banker shall file a statement with the board:
   1. Giving a list of complaints received by it.
   2. A statement whether it is proposed to amend or not

Mandatory collection centres the minimum number of collection centres for an issue of capital shall be:

- The four metropolitan centre situated at Mumbai, Delhi , Calcutta and Chennai,
- All such canters where stock exchange are located in the region in which the registered office of the company is situated.
- The regional division of collection centres.

Authorized collection agents: The issuer company can appoint authorized collection agents in consultation with the lead merchant banker, subject to necessary disclosures including the names and addresses of such agents are made in the offer document. The collection agents may collect such applications, as are accompanied by payment of application monies paid by cheque, drafts. The application forms, along with the duly reconciled schedules, shall be forwarded by the collection agent to the registrar issue

• Agreements with depositors the lead manager shall ensure the issuer company have entered into agreements with all the depositories for dematerialization of securities. He shall also ensure that an option be given to the investors to receive the allotment of securities in a dematerialized form, through any of the depositors.

Post-Issue Obligations

Post issue monitoring reports the post issue lead merchant banker shall ensurethesubmissionofthepost issue monitoring reports Due-diligence certificate to be submitted with the final postissue monitoring report. The post issue lead merchant banker shall file a duediligence certificatein the format specified along with the final post issue monitoring reportRedressal of the investor grievances the post-issue lead merchant banker shall actively associatehimself with post-issue activities namely allotment, refund and despatch and shallregularly

monitor redressal of investor. Coordination with the intermediaries the post-issue lead merchantbanker shall maintain close coordination with the Registrars to the Issue. Any act of omission orcommission on the part of intermediaries shall be reported to the BoardUnderwriters the lead merchant banker shall satisfy himself that the issue is fully subscribedbefore announcing closure of the issue the lead merchant banker shall ensure that theunderwriters honor their commitment within 60 days from the date of closure of the issue. Thelead merchant banker shall furnish information in respect of underwriters who failed to meettheir underwriting developments

Bank to issue: The post-issue lead merchant banker shall ensure that moneys received pursuantto the issue are kept in a separate bank (i.e Bankers to issue) as per the provisions of section73(3) of the companies act, 1956. Post issue advertisements Post- issue lead merchant bankershall ensure that in all issues, advertisement giving details relating to oversubscription, basis onallotment, number, value and percentage of application received etc. is released within 10 days.Basis of allotment in a public issue of securities, the managing director along with the leadmerchant banker and the registrar to an issue, shall ensure that basis of allotments is finalized ina fair and proper manner Proportionate-allotment Procedure an allotment shall be made on aproportionate basis within the specified categories. The proportionate allotments of securities in an issue that is over subscribed shall be subject to reservation for their tail individual investors as described in the following:

A minimum 50% of the net offer of securities to the public shall initially be made available forthe allotment to retail individual investors as the case may be the balance net offer of securities

to the public shall be made available for allotment to:

a) Individual applicants other than retail individual investors

b) Other investors including corporate bodies/institutions, irrespective of the number of shares, debentures and so on, applied for.

SEBI Guidelines for Debenture Issue

The amount of working capital debenture should not exceed 20% of the gross current assets.

- The debt equity ratio should not exceed 2:1
- The rate of interest can be decided by the company
- Credit rating is compulsory for all debentures excepting debentures issued by public sector
- Companies, private placement of Non-convertible Debenture (NCD) with financial
- institutions and banks.

- Debentures are to be redeemed after the expiry of seven years from the date of allotment.
- NCD is permitted to be redeemed at 5% premium.
- Normally debentures above seven years cannot be issued.
- Debentures issued to public have to be secured and registered.
- A debenture redemption reserve is to be set up out of profits of the company.
- Debentures Trustee and Debenture Trust deed are to be finalized within six months of the public offer.
- Fully convertible Debenture, Partially convertible Debenture, Non-convertible Debenture
- FCD/PCD/NCD issued for a period of more than 18 months are to be compulsorily credit rated. The debentures converted within 18 months are treated as equity
- FCDs having conversion period more than 36 months will not be permitted.
- The terms of issue should be predetermined and stated in the prospectus.
- The interest rate can be determined by the issuer.
- Conversion after 18 months from the date of allotment but before 36 months will be optional at the hand of the debenture holders.
- Appointment of debenture trustee and creation of debenture redemption reserve are not
- Necessary if the maturity period 18 months or less.
- The debenture trust deed should be executed within 6 months of the closure of the issue.
- The offer document should specify existing and future equity, long term debt equity ratio, servicing of existing debentures, payment of interest on existing loans and debenture.
- No objection for second charge.

Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008
(1)An issuer desirous of making an offer of debt securities to the public shall make an application for listing to one or more recognized stock exchanges in terms of sub-section (1) of section 73 of the Companies Act,1956(1 of 1956).
(2) The issuer shall comply with conditions of listing of such debt securities as specified in the Listing Agreement with the stock exchange where such debt securities are sought to be listed.

Conditions for listing of debt securities issued on private placement basis 20.
(1) An issuer may list its debt securities issued on private placement basis on a recognized stock Exchange subject to the following conditions:

(a) The issuer has issued such debt securities in compliance with the provisions of the Companies Act, 1956, rules prescribed thereunder and other applicable laws;
(b) Credit rating has been obtained in respect of such debt securities from at least one credit rating agency registered with the Board;
(c) The debt securities proposed to be listed are in dematerialized form;
(d) The disclosures as provided in regulation 21 have been made.

(2) The issuer shall comply with conditions of listing of such debt securities as specified in the listing Agreement with the stock exchange where such debt securities are sought to be listed.
Disclosures in respect of Private Placements of Debt 21.
(1) The issuer making a private placement of debt securities and seeking listing thereof on a recognized stock exchange shall make disclosures as specified in Schedule I of these Regulations accompanied by the latest Annual Report of the issuer.

(2) The disclosures as provided in sub-regulation (1) shall be made on the web sites of stock exchanges where such securities are proposed to be listed and shall be available for download in PDF / HTML formats.

2. Dematerialization: One of the primary functions of a depository is to eliminate or minimize the movement of physical securities in the market. This is achieved through De materialisation.De materialization or demat is the process of converting the securities held in physical form into an electronic record form or to directly allot securities in electronic record form. These electronic records of securities are shown as "electronic balances" in the demat accounts of investors.

3.Rematerialisation: is the process by which a client can get his electronic holdings converted into physical certificates.

4. Transfer of Securities: The depository gives effects to all transfers resulting from the settlement of trades and other transactions between various beneficial owners by recording entries in the accounts of such beneficial owners.

5 Corporate Actions: is a process by which a company gives benefits to the investors who are holding securities of the company. Types of corporate actions corporate actions are classified into two main categories. Cash and Non-cash corporate actions. Cash corporate action results in investors getting benefits in form of cash. Examples of cash corporate actions are payment of interest / dividend. Non cash corporate actions result in the investors getting benefits in form of securities. Examples of non-cash corporate action are bonus, rights, etc.

5. **Cash Corporate Actions:** The Issuer/R&T agent will distribute dividend, interest and other monetary benefits directly to the beneficial owners on the basis of list provided by Depository.

Non-cash Corporate Actions:

- Depository will provide the details of the beneficial owners and their holding to issuer/RTA.
- The Issuer / RTA then submit an allotment file to Depository containing the details of allotments to BOs.
- Based on the said allotment file the securities are credited to the demat accounts of the BOs.

Module 2:
Depository System

Depository System:
Objectives, activities, interacting systems, role of depositories and their services, Advantages of depository system - NSDL and CDSL. The process of clearing and settlement through Depositories, Depository Participants. Regulations relating to Depositories-SEBI (Depositories and Participants) Regulations 1996- Registration of depository and participant- Rights and Obligations of depositories and participants- Recent amendments Custodial services- The Stock Holding Corporation of India Limited

Depository System

The term depository is defined as „a central location for keeping securities on deposit‟. It is also defined as „a facility for holding securities, either in certified or uncertified form to enable book entry transfer of securities. It is understood from the above two definitions that the depository is a place where securities are stored, recorded in the books on behalf of the investors.

A system in which securities of an investor are held by depository on behalf, and at the request, of an investor in an Electronic Form. This system is also know as Scrip Less Trading system.

The Need and Objective of Depository System in India:

The old trading system /Traditional Scrip Based System was affected by a lot of problems such as: Enormous paperwork Time consuming/longer settlement cycles Poor infrastructure Bad deliveries due to signature difference, mistake in completing details in transfer deeds, litigation in respect of shares purchased, fake certificates, tearing/mutilation of certificates, postal delays, processing time taken by companies. Huge transaction cost

Functions of a Depository:

1. **Account Opening:** An investor wishing to avail depository services must first open an account with a depository participant registered with a depository. The process of opening a demat account is very similar to that of a bank account. The account opening form must be supported by copies of any one of the approved documents which serve as proof of identity and proof of address as specified by SEBI. Apart from these PAN card has to be shown in original at the time of account opening W.E.F April 01, 2006.

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- Based on the said allotment file the securities are credited to the demat accounts of the BOs.

6. **Pledge and Hypothecation:**
The securities held with the depository may be used as collateralto secure loans and other credits by the clients. Both pledgee and pledger are required to have ademat account. The pledged securities are blocked in favour of pledgee /lender, who can releasethe pledge once the loan is repaid by the borrower. In case of default by the pledgor or any otherreason agreed by pledgor and pledgee, the pledgee , as per the terms of the agreement, mayinstruct his DP to invoke the pledge. The pledgee BO has to submit an "Invocation RequestForm" (IRF). On execution of this instruction, the securities are transferred into the pledgee‟saccount.

7. **Account freezing:** Account freezing means suspending any further transaction fro depository account till the account is unfrozen. An investor, by issuing instructions to depository, in which he is maintaining demat account, can get his account frozen till further instructions.
8. **Transmission :** The word "transmission" means devolution of title to shares, for example, devolution by death, lunacy, bankruptcy, winding-up (in case of corporate) etc. The claimant should submit to the concerned DP an application with Transmission Request Form (TRF) along with documents like death certificate, Succession certificate, Probate of the will, Letter of administration. The major advantage in case of dematerialized holdings is that the transmission formalities for all securities held in a demat account can be completed just by interaction with the DP alone.

Role of depositories

The role of depository participants in stock market is very important. Now a days all kinds of trading works in stock market are being executed through internet and the basis of most part of the entire infrastructure of a depository is constituted in electronic form. In this article I will try to give all outcanenjoy while trading in stock market.

Advantages o f depository system

Benefits to investor

- This system will eliminate paper work
- The risk of bad deliveries, fraud and misplaced, mutilated
- The electronic media will shorter settlement time.
- Investors will change portfolio more frequently.
- The distribution of dividends, interest and other benefits will be speedier.
- Cost of transfer is less as the share transfer
- Faster payment in case of sale of shares.

Benefits to companies

- The companies will be able to know the particulars of beneficial owners and their holdings periodically.
- At the time of declaration of dividends, bonus s, etc, there will not be any rush for transfer related activities for the companies.

Benefits to the capital market

- The capital market will be more transparent as the trading, clearing and settlement mechanism have to be highly automated and interlinked with the depositary among them.
- The market will be highly automated and efficient due to the above two aspect.
- The foreign investors will start participating in the market resulting in a more buoyant
- Capital market.
- The existence of depository will result in increase in the volume of trade both by number and value.

National Securities Depositary Ltd (NSDL)

The first depositary in India. The national securities Depositary Ltd (NSDL) was established in 1996. It has been promoted by the Industrial Development Bank of India. Unit trust of India and NSE.

NSDL started operations in November 1996 and has made significant progress since then.

NSDL performs a wide range of securities related functions

- Maintenance of individual investor‟s beneficial holdings in an elective form.
- Dematerialization of securities.
- Account transfer for settlement of trade in electronic shares.
- Allotments in the electronic form in case of initial public offerings.
- Distribution of non-cash corporate actions.
- Facility for freezing or locking of investor accounts.
- Facility for pledge and hypothecation of securities.

In the first 16 months of its operations, 186 companies constituting over 50% of the total market. Capitalizations have signed up agreements with NSDL to get their securities admitted for dematerialization. A total of 163 crore shares values at Rs.19,600 crores have already been dematerialized.

According to NSDL, the dematerializations volume has crossed Rs.4,63,385 crores as on March 2001. There are 341 depository participants operational as on March 2007 which are providing services at about 1452 locations in India. Over 24 lakh clients have opened accounts with these DPs. There are 5632 corporate which have signed agreements with NSDL of which securities of 6973 corporate as available for dematerialization.

Right now, seven stock exchanges, the NSE, BSE, CSE, DSE, luthiana and Bangalore stock exchanges have established connectivity with NSDL.

Central Depository Services (India) Ltd (CSDL)

The CSDL has been set up by Bombay stock exchange and co-sponsored by SB, Bank of India, Bank of Baroda and HDFC Bank. It commenced its operations on March 22, 1999. Up to March2000, 680 companies made available their shares for demat. The market value of dematerialized securities amounted to Rs. 8188 crore. The number of beneficial owners stood at 28545. As on April 2008 there were 422 depository participants with 5771 DP service centers. The number of investors account was 52, 68,932. 6063 companies made available their shares for demat as on April 2008. There were 422 depository participants with 5771 DP service centers.

Objectives of CSDL

- To make a major trust on individual investors to participate in depository services.
- To create a competitive environment this will be responsive to the user‟s interest and demands.
- To enhance liquidity.

The process of clearing and settlement through Depositories

There are basically three tasks that are performed in the process of buying and selling of securities. They are:

- Trading
- Clearing
- Settlement

Trading basically deals with putting an order and its execution. Clearing deals with determination of obligations, in terms of funds and securities. Settlement means that the trade will be completed and NSCCL acts as a counter party and takes an obligation for the same. It has created a faith in the investors that all the trades would be settled and in no case any investor will have to face any problem of insufficient funds and securities. NSCCL acts as a buyer to every seller and a seller to every buyer. This principle is called **novation.** In case of default by any party, the NSCCL takes action against the defaulter.

The following **steps** are followed in the settlement of a trade:

Step 1: Determination of obligations:

Obligations are determined by NSCCL for the tradersand acts as a central counter-party (CCP) to the members. It determines the obligations of the members as what they ought to give and receive on the due date.

Step 2: Pay-in of funds and securities:

The members, after knowing their obligations, make available the funds and securities to NSCCL. The member‟s depository having obligation to pay in the securities; get an instruction from the NSCCL to pass the required entry for the transfer of securities to them. For the members having an obligation to pay-in funds, NSCCL gives an instruction to the clearing banks for the same.

Step 3: Pay-out of funds and securities:

After processing the shortages of funds and securities
and arranging for the movement of the same, NSCCL sends out electronic instructions to the clearing banks/ depositories to pass the required entries for the same.

Step 4: Risk management:

Since there is a time lag between execution of trade and its settlement, there are chances of default. To minimize the risk of defaults, NSCCL has framed a comprehensive risk management and surveillance system. Under this, the organization keeps a check through various systems (on-line and off-line monitoring) and in case of default panelizes
the respective trader for the same.

Depository Participants:

A“DepositoryParticipant”(DP)isanagentofthedepositorywhoisauthorizedtoofferdepositoryservis
to investors. They are the intermediaries between the depository and theinvestors. Therelationship between the DPs and the depository is governed by an agreementmade between thetwo under the Depositories Act, 1996. In a strictly legal sense, a DP is anentity who is

registeredas such with SEBI under the provisions of the SEBI Act.A DP is the first point of contact withthe investor and serves as a link between the investor andthe company through depository indematerialization of shares and other electronic transactions.According to SEBI, the followingcan apply for DP: Public financial institutions, scheduledcommercial banks, foreign banksoperating in India with the approval of the Reserve Bank ofIndia, state financial corporations,custodians, stock-brokers, clearing corporations / clearinghouses, NBFCs and registrar to an issue or share transfer agent complying with the requirementsprescribed by SEBIcanberegistered as DP.

Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996:

Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996

A. Registration of Depository

(1) An application for the grant of a certificate of registration as a depository shall be made to the board by the sponsor and shall be accompanied by the fee Rs. 50,000 in the form of a demand draft or bankers‟ cheque payable to the SEBI, Mumbai.
(2) The application shall be accompanied by draft bye-laws of the depository that is proposed to be set up.
(3) A Sponsor who is applying for registration as Depository may be: a public financial institution a bank included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 a foreign bank operating in India with the approval of the Reserve Bank of India;
(4) A Recognized stock exchange
(5) A body corporate engaged in providing financial services where not less than seventy five percent. of the equity capital is held by any of the institutions mentioned in above sub-clauses
(6) A body corporate constituted or recognized under any law for the time being in force in a foreign country for providing custodial, clearing or settlement services.
(7) An institution engaged in providing financial services established outside India and approved
(8) by the Central Government;

B. Grant of certificate of registration. :

After the Board is satisfied that the company established by the sponsor is eligible to act as depository, it may grant a certificate of registration to the depository subject to the following:

(a) The depository shall pay the registration fee of Rs. 25,00,000, within 15 days of receipt of information.
(b) The depository shall comply with the provisions of the Act, the Depositories Act, the bye-laws, agreements and these regulations;
(c) The depository shall not carry on any activity other than that of a depository
(d) The sponsor shall, at all times, hold at least fifty one per cent. of the equity share capital of the depository.

C. Payment of annual fee. :

Payment of annual fee. A depository who has been granted a certificate of registration under shall pay annual fee of Rs. 10,00,000 to SEBI.

D. Certificate of Commencement Of Business:

A depository, which has been granted a certificate of registration shall within one year from the date of issue of such certificate make an application to the Board for commencement of business.

E. Registration of Participant

Application for grant of certificate of Registration. An application for the grant of a certificate of initial registration as a participant shall be made to the Board, through each depository in which the applicant proposes to act as a participant, along with application fee of Rs. 5000.

F. Consideration of application for grant of certificate of initial registration:

The applicant belongs to one of the following categories

(i) A public financial institution as defined in section 4A of the Companies Act, 1956 (1 of 1956);

(ii) A bank included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(iii) A foreign bank operating in India with the approval of the Reserve Bank of India;

(iv) A state financial corporation established under the provisions of section 3 of the State Financial Corporations Act, 1951 (63 of 1951);

(v) An institution engaged in providing financial services, promoted by any of the institutions mentioned in sub clause (i),(ii), (iii), (iv) jointly or severally;

(vi) A custodian of securities who has been granted a certificate of registration by the Board

(vii) A clearing corporation or a clearing house of a stock exchange;

(viii) A stock broker who has been granted a certificate of registration by the Board

G. Grant of certificate of initial registration.

On being satisfied that the applicant is eligible and has complied with the conditions stipulated in the SEBI (D&P) Regulations, SEBI grants a initial registration certificate to the applicant. SEBI considers, inter alia, whether the applicant has adequate infrastructure and systems. Grant of initial registration is also subject to the condition that the Participant shall redress the grievance of beneficial owners within thirty days of the date of receipt of the complaint and keep the depository informed about the number and nature of redress. The participant shall pay the registration fee Rs. 1,00,000 and annual fees of Rs.1000.

H. Period of validity of the certificate of initial registration.:

The certificate of initial registration granted shall be valid for a period of five years from the date of its issue to the applicant.

I. Grant of certificate of permanent registration:

Grant of certificate of permanent registration A participant who has been granted a certificate of initial registration may, three months before the expiry of the period of certificate of initial registration, make an application for grant of a certificate of permanent registration through the depository in which it is a participant.

Custodial services

Custodian, A financial institution that holds customers' securities for safekeeping so as to minimize the risk of their theft or loss. A custodian holds securities and other assets in electronic or physical form.

Rights and Obligations of Depositories :

Depositories have the rights and obligations conferred upon them under the Depositories Act, the regulations made under the Depositories Act, Bye-Laws approved by SEBI, and the agreements made with the participants, issuers and their R&T agents. Every depository shall, in its bye-laws, state the specific securities which are eligible for being held in dematerialised form in the Depository. Securities eligible for Dematerialization: shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate; (b) units of mutual funds, rights under collective investment schemes

adventure capital funds, commercial paper, certificates of deposit, securitized debt, money market instruments, Government Securities and unlisted securities shall also be similarly eligible for being held in dematerialized form in a depository. (c) any other security as may be specified byte Board from time to time.
Either on the issuer or on the investors exercising an option to hold his securities with a depository in de materialised form, the issuer shall enter into an agreement with a depository to enable the investor to dematerialise the securities. Every depository shall allow any participant to withdraw or transfer its account, if the request for such withdrawal or transfer is in accordance with conditions stipulated there for in the bye-laws of the depository.
The DP should maintain and preserve the following records and documents depository wise for a minimum period of 5 years: records of all the transactions entered into with a depository and with a beneficial owner. Details of securities dematerialised, rematerialised on behalf of beneficial owners. Records of instructions received from beneficial owners and statements of account provided to beneficial owners Records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be. No participant shall assign or delegate its functions as participant to any other person, withoutthe prior approval of the depository.

Stock Holding Corporation of India Ltd.

SHCIL was incorporated as a Public Limited Company in 1986.with its registered office in Mumbai, Maharashtra. It has been jointly promoted by leading Banks and Financial Institutions .SHCIL is a subsidiary of IFCI Limited. The equity capital of SHCIL is presently held by LIC, GIC, IFCI Ltd., SU-UTI, NIA, NIC, UIC, and TOICL, all leaders in their respective fields of business.
The Ministry of Corporate Affairs has recently issued a Circular, notified in the Gazette of India G.S.R. 352(E) dated May 10, 2012, notifying the Rule “Investor Education and Protection Fund (Uploading of information regarding unpaid and unclaimed amounts lying with Companies) Rules, 2012”. As per this Rule, companies have to identify and upload details of unclaimed dividend on their website.

SHCIL services

- Custodial Services
- Registration of Foreign Portfolio Investor
- Clearing & Settlement(Cash)
- Electronic & Physical Safekeeping
- F&O Clearing
- Asset Servicing
- Premium Offerings
- Securities Escrow Account services

SHCIL provides first-rate custodial services to India‟s leading Financial Institutions, Insurance Companies, Mutual Funds, Foreign Institutional Investors (FII‟s), Banks, Indian and Foreign Venture Capital Companies, Funds, PF Trusts & Corporates.

Clearing & Settlement Services (Cash Segment)

- Smooth Straight through Processing (STP) systems with a choice of two reputed service
- providers, enabling the competitive advantage of efficient settlements.
- Seamless monitoring and constant updates on failed trades and status (T+2 basis)
- Daily verification of settlements (Normal/Auction), thus mitigating systemic risks.
- Efficient fund transfer facilities offering flexibility of settlement of funds through wide

- panel of banks having RTGS (Real Time Gross Settlement) capabilities.
- Effortless handling of residual trades in physical mode, since it has the necessary infrastructure in place.

Electronic & Physical Safekeeping Services

• Operations on both Depositories, National Securities Depository Limited & Central Securities Depository Limited, manned by qualified, certified & experienced staff, complemented by cutting-edge back-office processes

• Comprehensive document tracking & storage systems that enable the instant tracking and status of any investments in physical custody.

Module 3:
Housing Finance:

Role, Types of housing loans, Institutions and banks offering Housing Finance, Procedure and Interest rates. Income Tax Implication. Reverse mortgage loan.

Non-Banking Finance Companies:

Types, Growth, Functions, RBI Guidelines, and Prudential Norms.

A housing finance is refers to finance provided to individuals or group of individuals including co-operative societies for purchase/build house or houses. The R.B.I. has states that banks are free to decide the guidelines on accepts such as age of dwelling units, repayment schedules,margin and security with the approved of their board. Housing Finance Retail Banking

Types of housing loans

The different types of Housing Finance are shown in the chart. Types of Housing Finance

Direct Finance- purchase another house, For letting it out for rent, Buy an old house, Purchase of plot borrower Declares that he intends to construct a house on the plot

Supplementary Finance - alteration/repairs

Indirect Finance - To other housing financial institution, provided after obtaining "Pain Passu" or he "Second Mortgage"

Purpose, Quantum

The housing loan provided for;

- Purchase of flat/house or purchase of plot of land.
- For renovation/repairs of an existing house/flat.
- For extending an existing house.

Short term bridge finance while purchasing another house/flat. The quantum of loan is vary from bank to bank normally bank stipulate minimum of Rs. 1,00,000/-. The maximum would depend on the bank and it could vary from Rs. 10 Lakhs to Rs. 2crores or more. For repairs the amount isless, around Rs. 10lakhs.

Eligibility and Terms of loan

All individuals are eligible who are above the age of 18years having sufficient income to repay the loan.

The loans are not normally extended to the individuals who are above 58 years of age. The amount of advance will be based on individuals gross pay or net take home pay. The criteria may be differs from bank to bank as per the suggestion of R.B.I. The terms or the period of repayment is also depend on age of buyer. Normally it is from 15 years to 25 years. The main aspect behind this is the amount of loan along with interest should be repaid before the person retires. Loans provided for self-employed personals are sometime a shorter duration.

Margin, Interest, Security

The housing loan is normally between 80% to 85% of cost of the house/flat. The entire amount is rarely advanced by nationalized bank. some private banks are now financing 100%amount. For housing loan there are two types of interest rate.

- Fixed for entire tenure of the loan: Which is charging through out the duration of
- Floating loan the security in respect of housing finance is the property purchase with a mortgage is taken on the same. For additional security guarantee may be taken.

Housing Loans under Priority Sector

The following housing finance limits will be considered as Priority Sector Advances:

Direct Finance

(i) Loans up to Rs. 15 lakh in rural, semi-urban, urban and metropolitan areas for construction of houses by individuals, with the approval of their Boards.
(ii) Loans up to Rs.1 lakh in rural and semi urban areas and Rs. 2 lakhs in urban areas for repairs to damaged houses by individuals.

Indirect Finance

Assistance given to any governmental agency for construction of houses, or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of Rs. 5 lakh of loan amount per housingunit.Assistance given to a non-governmental agency approved by the National Housing Bank for the purpose of refinance for reconstruction of houses or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of Rs. 5 lakh of loan amount per housing unit.

Housing Development Finance Corporation Limited (HDFC)

HDFC is one of the leaders in the Indian housing finance market with almost 17% market shareas on March 2010. Serving more than 38 lakh Indian customers as on March 2011
In the FY 2010-11, it registered a net profit of `4528.41 crore. It also registered a net profit of 971 crore in the quarter ended September 30, 2011.
HDFC provides

- Home Loan
- Home Improvement Loan
- Home Extension Loans
- Land Purchase Loans
- Top – Up Loans

State Bank of India

State Bank of India is another major player in the Indian housing finance market with 17% of the market share, same as HDFC's share as on March 2010. The SBI Housing Loan schemes are specifically designed to meet the varied requirements of the customers. SBI Home Finance registered a net profit of ` 24.63 crore in the year ended March 31, 2009.

- SBI Surakshit Home Loan
- SBI Yuva Home Loan
- SBI Home Loan PAL (Pre-Approved Limit)
- SBI Maxgain (Home Loan as an overdraft)
- SBI Realty
- NRI Home Loans
- Gram Niwas

LIC Housing Finance Limited

LIC Housing Finance is another major player in housing finance sector in India with about 8% of market share. Promoted by Life Insurance Corporation of India, LICHFL has an extensive distribution network with a strong brand presence. Recently, the company has been awarded “Consumer Super brand 2009/10 Status” by Super brands Council. In the last financial year (ended on March 31, 2011), LICHFL earned a net profit of ` 974.49 crore, comparing to ` 662.18 in the previous FY. It also registered a net profit of ` 256.50 crore in April- June quarter of 2011.

- Purchase of flats/house
- Construction
- Extension of flats/house
- Plot purchase
- Repairs/renovation to existing flats/house

Home Loan Procedure in India:

Submission of Application Form : After choosing a particular home loan, the customer submits the application form to the housing finance company (HFC) along with other relevant documents as required by the HFC. They comprise documents to establish income, age, residence, employment, investments, etc. The customer also needs to hand over a cheque for payment of an up front (non -refundable) processing fee of about 0.5-1% of the loan amount to the HFC.

Validation of the Information: In the next stage, HFCs validate the information provided by the customer on the application form. They usually conduct checks on the residential address of the customer, the place of employment of the customer, and credentials of the employer. Some HFCs may insist on a personal interview with the customer and perform a reference check on the references provided by the customer on the application form.

Issue of Sanction Letter : After due appraisal of customer profile, a sanction letter is issued which contains details such as loan amount, rate of interest, annual / monthly reducing balance, tenor of the loan, mode of repayment and general terms and conditions of the loan. This is the actually the approval of the money lending procedure by the company. However, the money is sanctioned only after the documents and the property on behalf of which the loan is being granted.

Submission of Documents: Once the sanction letter is passed, the customer is required to leave The entire set of original documents pertaining to the property being purchased with the HFC as Security for the loan amount sanctioned. These documents remain in the custody of the HFC till the time the loan is fully repaid. Once the documents are handed over to the HFC, they send all The documents for a thorough legal scrutiny.

Validation of Property: Prior to disbursement, the HFC also conducts a site visit to the customer's property to ensure that all construction norms have been adhered to properly. Once the HFC is satisfied that the property is legally and technically clear, they disburse the loan amount. The disbursement from the HFI is on the basis of the stage of construction of the property.

Payment Procedure: Once all the above mentioned process, the borrower is entitled to take the Money from the lender party. Until such time that the entire sanctioned amount is not drawn, the customer is supposed to pay a simple interest on the Actual Amount drawn (without any principal repayments). The EMI payments commences only after the entire sanctioned loan Amount is drawn.

Or

Application form

The first step involved in applying for home loan is the procurement of application form from the HFC of your choice. The Performa of application every HFC (Housing Finance Companies) is different from the other but about 80% information required to be furnished is the same. Along with the application form necessary documents like address proof, age proof, proof of income ,bank balance etc. are also to be attached with the application form before it is submitted to the HFC. Along with all these documents HFCs also ask for processing fee of the home loan that varies 0.25% to 0.50% of the total loan amount.

Personal Discussion

After successfully filling the application form and submitting it to the authority the next step is face to face with bank or HFC where you have applied for the home loan. The bank first evaluates the papers submitted and summons the applicant for the personal discussion regarding the home loan applied for. It is advisable that you carry all your original documents of whose copy you have submitted along with the application.

Bank's Field Investigation

The next step is the field investigation done by the HFC or banks. They sent their representatives to the existing residence of the applicants or their offices for the validation of the documents submitted. This is the essential part for the banks to establish the trust with the applicants.

Credit appraisal by the bank and loan sanction

This is the make or break stage of the process. The bank or HFC will establishes repayment capacity based on your income, age, qualifications, experience, employer, nature of business etc.to access your credential. The bank can refuse your loan application is any discrepancy is fondant this stage. But if everything goes according to the conditions negotiated by both the parties then the bank or HFC sanction the loan that may be unconditional or with some conditions
Levied.

Offer Letter

After the sanction of the Home Loan, the applicant gets offer letter from the bank or HFC with the following details:

- Loan amount
- Rate of Interest
- fixed or variable ROI
- Tenure of the loan
- Mode of repayment
- General terms and conditions of the loan
- Special conditions, if any

If the terms and conditions are agreed the applicant has to sign the duplicate copy of the offer letter and that is to be submitted to the Bank or HEC.

Submission of legal documents & legal check

The bank or the HFC now asks for the legal documents of the property involved for applying home loan. All the legal documents of the property involved have to be submitted. The bankdoes all the legal checks on the property. The documents remain with the bank until the repayment of the Home loan.

Technical / Valuation check

The Banks or HFC then go about the technical valuation of the property. The experts of the bank visit the site that has to be purchased and value it as per the existing rules and regulations. The valuation of the property is the most important aspect that the bank considers before financing any property.

Registration of property documents

After the legal and technical valuation of the property the draft documents has to be cleared by the lawyer and stamping and registration of the documents is needed.

Signing of agreements and submitting post-dated cheque

Now it is time of signing the final agreement of the home loan. After the signing of the agreement a bunch of postdated cheques are to be submitted as agreed on the agreement paper.

Disbursement

It is time for the final Disbursement of the Home Loan. After the bank or HFC ensures financing the property is involves no risk they pay the final amount that is agreed upon. The mode of payment varies from full to part payment. In the case of under construction property the mode is part payment and in the case of ready possession properties disbarment is full and final.

Income tax implications:
As per Sec 24(b) of the Income Tax Act, 1961 a deduction up to Rs. 1,50,000 towards the total interest payable on the home loan towards purchase / construction of house property can be claimed while computing the income from house property. (The deduction stands reduced to Rs. 30,000 in case of loans taken prior to Mar 01, 1999). The interest payable for the reacquisition or pre - construction period would be deductible in five equal annual installments commencing from the year in which the house has been acquired or constructed.

Reverse mortgage loan.

A type of mortgage in which a homeowner can borrow money against the value of his or her home. No repayment of the mortgage (principal or interest) is required until the borrower dies or the home is sold. After accounting for the initial mortgage amount, the rate at which interest accrues, the length of the loan and rate of home price appreciation, the transaction is structured so that the loan amount will not exceed the value of the home over the life of the loan.

Non-Banking Financial Company

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 1956 and is engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/ securities issued by Government or local authority or other securities of like marketable nature, leasing, hire-purchase, insurance business, chit business. It does not include any institution whose principal business is that of agriculture activity, industrial activity, sale/purchase/construction of immovable property.

A non-banking institution which is a company and which has its principal business of receiving deposits under any scheme or arrangement or any other manner, or lending in any manner. •The deposits received do not involve investment, asset financing, or loans. Besides the above class Growth: 13000+ players registered under RBI : A & B categories, Spread all across the country,Approx. 570 NBFCs authorized to accept public deposits (Catg. A), Assets worth Rs. 15000 crore financed annually & growing steadily, Asset financing, Commercial vehicles, Passenger cars, Multi-utility & multi-purpose vehicles, Two-wheelers & Three-wheelers, Construction equipment - Consumer durables.

ROLE OF

As recognized by RBI & Expert Committees / Taskforce - Development of sectors like Transport& Infrastructure Substantial employment generation, Help & increase wealth creation, Broad base economic development, Irreplaceable supplement to bank credit in rural segments, major thrust on semi-urban, rural areas & first time buyers / users, to finance economically weaker sections, Huge contribution to the State exchequer70-80% of Commercial Vehicles are finance driven, Indian economy is more dependent on roads, Heavy Govt. outlay for mega road projects, Heavy replacement demand anticipated – 30Lacks commercial vehicles by the year 2007, Another Rs.6000 Crores required for phasing out old commercial vehicles, CRISIL in its study has placed commercial vehicle financing under “low risk” category, Each commercial vehicle manufactured, sold and financed gives employment to minimum 20 persons (direct and indirect)

Customer Service:

The key factor for our survival & growth, NBFCs provide prompt, tailor made service with least hassles. This more than compensates for the higher lending rates of NBFCs as compared to Banks& FIs, All customers get direct and easy access to and individual attention of the top management, NBFCs cater to a class of borrowers who :- - Do not necessarily have a high-income, But have adequate net worth, Are honest and sincere (gauged by the personal touch

maintained with them)RBI has been taking efforts to tighten control over NBFCs, which are more loosely regulated than banks. Any takeover or merger involving deposit-taking NBFCs now requires the prior approval of RBI. In addition, the management of the merged entity must comply with the „fit and proper‟ criteria of RBI. RBI also chided NBFCs involved in micro-finance for charging high rates while accessing cheaper funds from banks. RBI‟s regulation revision of NBFC‟s in its annual report (August, 25th, 2010)
The end-borrowers do not get the benefit of low interest rates, as NBFCs are assigned the responsibility of managing the loans. Consequently, the borrower continues to pay the same rate of interest, which is as high as 23.6-30 per cent. •According to the banking regulator, there are 12systematically important non-deposit NBFCs that are lenders with an asset size of at least Rs 100crore engaged in micro-finance lending. "The main sources of funds for these NBFCs are borrowings from banks and financial institutions. Most of them have received large amounts as foreign direct investment and many of them are now largely foreign-owned,"

Role of Non- Banking Financial Companies

(1). Promoters Utilization of Savings:

Non- Banking Financial Companies play an important role in promoting the utilization of savings among public. NBFC‟s are able to reach certain deposit segments such as unorganized sector and small borrowers were commercial bank cannot reach. These companies encourage savings and promote careful spending of money without much wastage. They offer attractive schemes to suit needs of various sections of the society. They also attract idle money by offering attractive rates of interest. Idle money means the money which public keep aside, but which is not used. It is surplus money.

(2). Provides easy, timely and unusual credit:

NBFC‟s provide easy and timely credit to those who need it. The formalities and procedures in case of NBFC‟s are also very less. NBFC‟s also provides unusual credit means the credit which is not usually provided by banks such as credit for marriage expenses, religious unction's, etc. The NBFC‟s are open to all. Every one whether rich or poor can use them according to their needs.

(3). Financial Supermarket:

NBFC ‟ s play an important role of a financial supermarket. NBFC ‟ s create a financialsupermarket for customers by offering a variety of services. Now, NBFC‟s areproviding avariety of services such as mutual funds, counseling, merchant banking, etc. apart from theirtraditional services. Most of the NBFC‟s reduce their risks by expanding their range of products
and activities.

(4). Investing funds in productive purposes:

NBFC‟s invest the small savings in productive purposes. Productive purposes mean they investthe savings of people in businesses which have the ability to earn good amount of returns. Forexample – In case of leasing companies lease equipment to industrialists, the industrialists cancarry on their production with less capital and the leasing company can also earn good amount ofprofit.

(5). Provide Housing Finance:

NBFC‟s, mainly the Housing Finance companies provide housing finance on easy term andconditions. They play an important role in fulfilling the basic human need of housing finance.Housing Finance is generally needed by middle class and lower middle class people. Hence,NBFC‟s are blessing for them.

(6). Provide Investment Advice:

NBFC‟s, mainly investment companies provide advice relating to wise investment of funds aswell as how to spread the risk by investing in different securities. They protect the smallinvestors by investing their funds in different securities. They provide valuable services toinvestors by choosing the right kind of securities which will help them in gaining maximumrateof returns. Hence, NBFC‟s plays an important role by providing sound and wise investmentadvice.

(7). Increase the Standard of living:

NBFC‟s play an important role in increasing the standard of living in India. People with lessermeans are not able to take the benefit of various goods which were once considered as luxury butnow necessity, such as consumer durables like Television, Refrigerators, Air Conditioners,Kitchen equipments, etc. NBFC‟s increase the Standard of living by providing consumer goodson easy installment basis. NBFC‟s also facilitate the improvement in transport facilities throughhire- purchase finance, etc. Improved and increased transport facilities help in movement ofgoods from one place to another and availability of goods increase the standard ofliving of thesociety.

(8). Accept Deposits in Various Forms:

NBFC‟s accept deposits forms convenient to public. Generally, they receive deposits from public by way of depositor a loaner in any form. In turn the NBFC‟s issue debentures, units "certificates, savings certificates, units, etc. to the public.

(9). Promote Economic Growth:

NBFC‟s play a very important role in the economic growth of the country. They increase the rate of growth of the financial market and provide a wide variety of investors. They work on the principle of providing a good rate of return on saving, while reducing the risk to the maximum possible extent. Hence, they help in the survival of business in the economy by keeping the capital market active and busy. They also encourage the growth of well- organized business enterprises by investing their funds in efficient and financially sound business enterprises only .One major benefit of NBFC‟s speculative business means investing in risky activities. The investing companies are interested in price stability and hence NBFC‟s, have a good influence on the stock- market. NBFC‟s play a very positive and active role in the development of our country.

Functions of Non- Banking Financial Companies:

(1). **Receiving benefits:**

The primary function of nbfcs is receive deposits from the public in various ways such as issue of debentures, savings certificates, subscription, unit certification, etc. thus, the deposits of nbfcsare made up of money received from public by way of deposit or loan or investment or anyotherform.

(2). Lending money:

Another important function of nbfcs is lending money to public. Non- banking financial companies provide financial assistance through.

a. Hire purchase finance:

Hire purchase finance is given by nbfcs to help small important operators, professionals ,and middle income group people to buy the equipment on the basis on Hire purchase. After the last installment of Hire purchase paid by the buyer, the ownership of the equipment passes to the buyer.

b. Leasing Finance:

In leasing finance, the borrower of the capital equipment is allowed to use it, as a hire, against the payment of a monthly rent. The borrower need not purchase the capital equipment but he buys the right to use it.

c. Housing Finance:

NBFC‟s provide housing finance to the public, they finance for construction of houses, development of plots, land, etc.

d. Other types of finance provided by NBFCs include:

Consumption finance, finance for religious ceremonies, marriages, social activities, paying off old debts, etc. NBFCs provide easy and timely finance and generally those customers which are not able to get finance by banks approach these companies.

e. Investment of surplus money:

NBFCs invest their surplus money in various profitable areas.

NBFC RBI draft guidelines for NBFCs

The RBI has released draft guidelines for NBFCs based on recommendations of the Usha Thorat Committee Report (released in August 2011) on issues and concerns in the NBFC sector. The objective of the committee was to address issues relating to regulatory arbitrage and systemic risk, so as to create a strong and resilient non-banking financial sector. The guidelines address risk concerns by way of higher capital adequacy, changed asset classification and higher provisioning norms and increased disclosures. We believe the guidelines, when implemented, will strengthen the NBFC sector in the medium to long-term. Further, the guidelines would alsoimpact profitability, lead to lower leverage and, consequently, impact RoE. However, we believethe impact would be limited for most major NBFCs owing to enough time being provided forfulfilling the requirements and the fact that many NBFCs already follow more stringentregulations than currently prescribed by RBI.

Key highlights of draft guidelines:

- The new guidelines propose that all NBFCs, whether deposit taking or not, shallmaintain Tier l capital at 10% vs. 7.5% required to be maintained currently whilethe requirement for overall capital adequacy ratio has been kept the same at 15%.The requirement of 10% Tier I capital is lower than the 12% originallyrecommended by the Usha Thorat Committee Report
- For infra finance companies, the Tier I capital ratio is already 10% and that hasbeen maintained • Captive NBFCs, the business models of which focus mainly(90% and above) on financing the parent company‟s products and NBFCs that areinto lending to/investment in sensitive sectors namely, capital market,commodities and real estate, shall maintain higher Tier I capital at 12%
- A three-year period would be given to existing NBFCs that do not fulfil thecapital adequacy requirement
- Risk weights for NBFCs that are not sponsored by banks or that do not have anybank as part of the group may be raised to 150% for capital market exposures(CME) and 125% for commercial real estate (CRE) exposures. In case of banksponsored NBFCs, the risk weights for CME and CRE shall be the same asspecified for banks
- As stated in the committee report, asset classification and provisioning normssimilar to banks shall be followed by NBFCs albeit in a phased manner

- At present, the period for classifying loans into NPAs in case of NBFCs is higherat 180/360 days compared to 90 days for banks. NBFCs will have to comply withthe requirement in the phased manner like, a 120 day norm shall be applied fromApril 1, 2014 to March 31, 2015 and a 90 day norm thereafter
- Further, a one-time adjustment of the repayment schedule, which shall not amountto restructuring will, however, be permitted

Prudential Norms:

The Reserve Bank put in place in January 1998 a new regulatory framework involving prescription of prudential norms for NBFCs which deposits are taking to ensure that these NBFCs function on sound and healthy lines. Regulatory and supervisory attention was focused on the „deposit taking NBFCs‟ (NBFCs – D) so as to enable the Reserve Bank to discharge itsresponsibilities to protect the interests of the depositors. NBFCs - D are subjected to certain bank
–like prudential regulations on various aspects such as income recognition, asset classification and provisioning; capital adequacy; prudential exposure limits and accounting / disclosure requirements. However, the „non-deposit taking NBFCs‟ (NBFCs – ND) are subject to minimal regulation. The application of the prudential guidelines / limits is thus not uniform across the banking and NBFC sectors and within the NBFC sector. There are distinct differences in the application ofthe prudential guidelines / norms as discussed below:

- Banks are subject to income recognition, asset classification and provisioning norms;capital adequacy norms; single and group borrower limits; prudential limits on capitalmarket exposures; classification and valuation norms for the investment portfolio; CRR /SLR requirements; accounting and disclosure norms and supervisory reportingrequirements.
- NBFCs – D are subject to similar norms as banks except CRR requirements andprudential limits on capital market exposures. However, even where applicable, thenorms apply at a rigour lesser than those applicable to banks. Certain restrictions apply tothe investments by NBFCs – D in land and buildings and unquoted shares.
- Capital adequacy norms; CRR / SLR requirements; single and group borrower limits;prudential limits on capital market exposures; and the restrictions on investments in landand building and unquoted shares are not applicable to NBFCs – ND.

Module 4
Factoring

Origin, Types, Factoring mechanism, advantages, factoring charges, International factoring, Factoring in India

Forfeiting: Origin, characteristics, benefits, difference between factoring and forfeiting, growth of forfeiting in India

Meaning:

Meaning The word "Factor" has been derived from the Latin word "Facere" which means "to make or to do or to get things done" Factoring may broadly be defined as the relationship, created by an agreement, between the seller of goods/services and a financial institution called the factor, whereby the latter purchases the receivables of the former and also controls and administers the receivables of the former.

Who is factor? Factor is a financial institution that specializes in purchasing receivables from business firms. Factor assumes the risk of collection of receivables and on the event of nonpayment by debtors/customers bears the risk of bad debt and losses

Definition:

Definition According to Peter M Biscose:- Factoring may also be defined as a continuousrelationship between financial institution (the factor) and a business concern selling goods and/or providing service (the client) to a trade customer on an open account basis, whereby the factor purchases the client‟s book debts (account receivables) with or without recourse to the client -thereby controlling the credit extended to the customer and also undertaking to administer the
sales ledgers relevant to the transaction.

Origin:

Factor came into existance in the year 1920. It was not an organised sector and Association of British Factors (ABF) came in 1976, Nearly 90% of global factoring turnover comes from USA& European countries, RBI appointed the C.S.Kalyanasundaram Committee (1988) It suggested to start factoring by a bank through its subsidiary's of today, Worldwide, factoring volume is more than USD 700 billion a year Spread over nearly 60 countries and covering more than 1,00,000 businesses. Particularly in developed countries, factoring is an accepted way of conducting business.

The study group appointed by International Institute for the Unification of Private Law(UNIDROIT), Rome during 1988 recommended, in simple words, the definition of factoring asunder: "Factoring means an arrangement between a factor and his client which includes at least two of the following services to be provided by the factor: Finance Maintenance of accounts Collection of debts Protection against credit risks".

Concept:

Concept Factoring is a specialized activity whereby a firm converts its receivable into cash by selling them to a factoring organization.

Client: Client is the person who wants to sell the commodity to the customer. Customer :- Customer is the person who wants that commodity but he do not have sufficient money. Factor :- Factor enters into agreement with the client for rendering factor services to it. The factor receives payment from the buyer on due dates and remits the money to seller after usual deductions.

Mechanism of Factoring:

The mechanism of factoring is summed up as below: i . An agreement is entered into between the selling firm and the firm. The agreement provides the basis and the scope understand in reached between the two for rendering factor service. ii. The sales documents should contain the instructions to make payment directly to the factor who is assigned the job of collection of receivables. iii. When the payment is received by the factor, the account of the firm is credited by the factor after deducting its fees, charges, interest etc. as agreed. iv. The factor may provide advance finance to the selling firm conditions of the agreement so require.

Types of Factoring:

1. Recourse and Non-recourse Factoring
2. Advance and Maturity Factoring
3. Conventional or Full Factoring
4. Domestic and Export Factoring
5. Limited Factoring
6. Selected Seller Based Factoring
7. Selected Buyer Based Factoring
8. Disclosed and Undisclosed Factoring

Recourse and Non-recourse Factoring:

Recourse and Non-recourse Factoring In a recourse factoring arrangement , the factor has recourse to the client (selling firm) if the receivables purchased turn out to be bad, then the riskof bad debts is to be borne by the client and the factor does not assume credit risks associated with the receivables. Thus the factor acts as an agent for collection of bills and does not cover the risk of customers failure to pay debt or interest on it .Whereas, in case of non-recourse factoring , the risk or loss on account of non-payment by the customers of the client is to be borne by the factor and he cannot claim this amount from the selling firm. Since the factor bears the risk of non-payment, commission or fees charged for the services in case of nonrecourse factoring is higher than under the recourse factoring. The additional fee charged by the factor for bearing the risk of bad debts/non-payment on maturity is called Del credere commission.

Advance and Maturity Factoring:

Advance and Maturity Factoring Under advance factoring arrangement, the factor pays only a certain percentage (between 75 % to 90 %) of the receivables in advance to the client, the balance being paid on the guaranteed payment date. As soon as factored receivables are approved, the advance amount is made available to the client by the factor. The Factor charges discount/interest on the advance payment from the date of such payment to the date of actual collection of receivables by the factor. In case of maturity factoring, no advance is paid to client and the payment is made to the client only on collection of receivables or the guaranteed payment data as the case may be agreed between the parties. Thus, maturity factoring consists of the sale of accounts receivables to a factor with no payment of advance funds at the time of sale.

Conventional or Full Factoring:

Conventional or Full Factoring Under this system the factor performs almost all services of collection of receivables, maintenance of sales ledger, credit collection, credit control and credit insurance. The factor also fixes up a draw limit based on the bills outstanding maturity wise and takes the corresponding risk of default or credit risk and the factor will have claims on the debt oars also the client creditor. It is also known as Old Line Factoring. Factoring agencies like SBI

Factors are doing full factoring for good companies with recourse.

Domestic and Export Factoring:

Domestic and Export Factoring The basic difference between the domestic and export factoring is on account of the number of parties involved. In the domestic factoring three parties are involved, namely: Customer (buyer) Client (seller) Factor (financial intermediary) All the three parties reside in the same country .Export factoring is also termed as cross-border/international factoring and is almost similar to domestic factoring except that there are four parties to the factoring transaction. Namely, the exporter (selling firm or client), the importer or the customer, the export factor and the import factor. Since, two factors are involved in the export Factoring, it is also called two-factor system of factoring. Two factor system results in two separate but inter-related contracts: 1. between the exporter (client) and the export factor. 2. Export factor and import factor. The import factor acts as a link between export factor and the importer, helps in solving the problem of legal formalities and of language. He also assumes customer trade credit risk, and agrees to collect receivables and transfer funds to the export factor in the currency of the invoice. Export/International factoring provides a non-recourse factoring deal. The exporter has 100 %protection against bad debts loss arising on account of credit sales.

Limited Factoring:

Limited Factoring Under limited factoring, the factor discounts only certain invoices on selective basis and converts credit bills into cash in respect of those bills only.

Selected Seller Based Factoring :

Selected Seller Based Factoring The seller sells all his accounts receivables to the factor along with invoice delivery challans, contracts etc. after invoicing the customers. The factor performs all functions of maintaining the accounts, collecting the debts; sending reminders to the buyersand do all consequential and incidental functions for the seller. The sellers are normally approved by the factor before entering into factoring agreement

Selected Buyer Based Factoring:

Selected Buyer Based Factoring The factor first of all selects the buyers on the basis of their goodwill and creditworthiness and prepares an approved list of them. The approved buyers of a company approach the factor for discounting their purchases of bills receivables drawn in the favor of the company in question (i.e. seller). The factor discounts the bills without recourse to seller and makes the payment to the seller.

Disclosed and Undisclosed Factoring:

Disclosed and Undisclosed Factoring In disclosed factoring, the name of the factor is mentioned in the invoice by the supplier telling the buyer to make payment to the factor on due date. However, the supplier may continue to bear the risk of bad debts (i.e. non-payments) without passing to the factor. The factor assumes the risk only under nonrecourse Factoring agreements. Generally, the factor lays down a limit within which it will work as non-recourse. Beyond this Limit the dealings are done on recourse basis i.e. the seller bears the risk. Under undisclosed factoring, the name of the factor is not disclosed in the invoice. But still thecontrol lies with the factor. The factor maintain sales ledger of the seller of goods, provides short-term finance against the sales invoices but the entire transactions take place in the name ofthe supplier company (seller).

Factoring Charges

Finance Charge - It represents the interest on funds made available to the client by way of prepayment against purchase of approved invoices.

Service Charge - The charge levied for rendering non-funding services such as collection, sales ledger maintenance and other advisory services.

Advances: Advances are made as a percentage of invoice value based on criteria, such as, quality of receivables, number and quality of the buyers and client‟s requirements. Typically 80% of invoice value is advanced.

Advantages (to the client):

- Immediate conversion of cash sale
- Competitive credit terms
- Accelerate the production cycle
- Free from tensions
- Efficient Working Capital Management
- Assessing quality of debtors
- Expansion of business

Advantages to the Buyers:

- Adequate credit facilities
- Getting periodical statement from the factor
- No affect on quality of goods, contractual obligations etc.

Benefits of International Factoring:

- **To the Exporter**
  - Deals with only one factor
  - He gets specialized knoweledge
  - Risk of B/D are reduced
- **To the Importer:**
  - Pays the invoice in the same country
  - Gets better credit terms

Factoring is not suitable under following cases - a) where large volume of cash sales take place. b) engaged in speculative business. c) selling highly specialized capital equipment‟s or made-toorder goods. d) where credit period offered to the buyers is more than 180 days. e) where there is Consignment Sale or Sale or Return Arrangements. f) where sales are to the sister / associated companies . g) where sales are to the public at large, etc.

Factoring in India:

Factoring in India SBI Factors and Commercial Services (SBI FACS) Ltd Canbank Factors Ltd Foremost Factors Ltd (FFL) Global Trade Finance Ltd (GTF) The Hongkong and Shanghai Bank Corporation Limited (HSBC) Export Credit Guarantee Corporation of India Ltd. (ECGC) India Factoring and Finance Solutions Pvt Ltd (India Factoring)

SBI FACS Ltd:

SBI FACS Ltd Subsidiary of State Bank of India. 1st factoring company to be set up in India .incorporated in February 1991 & commenced business operations from April 1991. SBI and its 2associate banks have a 70% stake in SBI Factors while 20% is held by SIDBI and 10% by Union bank of India. offers Domestic Factoring with recourse and without recourse, purchase bill factoring, factoring of Usance Bills etc.Jointly promoted by the Canara Bank, Andhra Bank and SIDBI in August,1992. its Rs. 10 crorepaid-up capital was contributed in the proportion of 60:20:20 by three promoters respectively.Initially operated in the south zone but regional restrictions on their operations weresubsequently removed by the RBI. main services provided by the Can bank

Factors Ltd are domestic factoring and invoice discounting.

Foremost Factors Ltd :
Foremost Factors Ltd incorporated in February 1996. promoted by Mohan Group and NationsBank Overseas Corporation of U.S.A. along with 20th Century Finance Corporation Limited(TCFC Limited) and ICDS Group as institutional investors. Changed its name to IFCI Factors Limited as when IFCI acquire the share capital of the company in 2008-09. major services are domestic sales bill factoring, purchase bill factoring, export sales bill factoring and corporate
loan.

Global Trade Finance Ltd:
Global Trade Finance Ltd joint venture between EXIM Bank, India‟s premier export finance institution, International Factoring Corporation(IFC) Washington, FIN Bank, Malta and Bank of Maharashtra. incorporated on March 13, 2001 with a paid-up capital of Rs. 45 crore . Offers export-financing solutions such as Forfaiting and Factoring for small and medium sized Indian exporters (SMEs) only factoring company in India to offer online web access to its clients for accessing their accounts.

SIDBI introduces its own direct factoring services in 1997-98 to help small scale sector in timely recovery of their sale proceeds. Factoring scheme of SIDBI is a comprehensive package of receivables management service including advance against invoices and other allied servicessuch as collection of proceeds from the purchaser, administration of sales ledger etc. aims to ensure adequate liquidity at all times.

The Hongkong and Shanghai Bank Corporation Limited discontinued providing factoring services in the year 2008 after providing this service for a period of 5 years. It has now relaunchedthe product with a few changes concentrating majorly on MSMEs. Services provided by HSBC are: Domestic Factoring, Invoice Factoring and Export Factoring.

The Export Credit Guarantee Corporation of India Limited is a company wholly owned by the Government of India. initially set up Export Risks Insurance Corporation (ERIC) in July1957. transformed into Export Credit and Guarantee Corporation Limited (ECGC) in 1964 and toExport Credit Guarantee of India in 1983. introduced non-recourse maturity export factoring. But later ECGC restructured its „maturity factoring‟ scheme and finally launched full fledgedfactoring scheme. Small and medium enterprises (SMEs) providing trade finance services and small-scale industries with a special focus on the ever-increasing international (export andimport) and domestic factoring. The objective of the Company is to provide factoring and forfaiting services, encompassing finance and value added services, efficiently and competently.

Forfaiting
Forfaiting is a form of financing of receivables pertaining to international trade. Forfaiting is the purchase of a series of credit instruments such as drafts, bills of exchange, other freely negotiable instruments on a nonrecourse basis. Forfaiting

Forfaiting, or Medium-Term Capital Goods Financing, means selling a bill of exchange, at a discount, to a third party, the Forfaiter, who collects the payment from an, essentially, overseas customer, through a collateral bank(s), and, thus, assuming the underlying responsibility of exporters and simultaneously providing trade finance for importers by converting a short-term loan to a medium term one. Done on a non - recourse basis used for international trade transactions, usually for transactions not less than $100,000.

Characteristics of forfaiting:

- Converts Deferred Payment Exports into cash transactions, providing liquidity and cash flow to Exporter.
- Absolves Exporter from Cross-border political or conversion risk associated with Export Receivables.
- Finance available upto 100% (as against 75-80% under conventional credit) withoutrecourse. Acts as additional source of funding and hence does not have impact on
- Exporter‟s borrowing limits. It does not reflect as debt in Exporter‟s Balance Sheet.
- Provides Fixed Rate Finance and hence risk of interest rate fluctuation does not arise.
- Exporter is freed from credit administration.
- Provides long term credit unlike other forms of bank credit.
- Saves on cost as ECGC Cover is eliminated.
- Simple Documentation as finance is available against bills.
- Forfait financer is responsible for each of the Exporter‟s trade transactions. Hence noneed to commit all of his business or significant part of business.
- Forfait transactions are confidential.

Benefits:

- Forfaiting eliminates risks (Political, commercial and transfer)
- Improves the cash flows by providing ready liquidity against transactional documents
- Forfaiting allows to discounting of bills.

Benefits to Exporters :

Benefits to Exporters Elimination of the cost and delays experienced in transacting business under LC The import factor offers credit risk protection in case buyer does not pay invoices within 90 days of due date ECGC policy cost can be saved. There is reduction is administrative Costas the exporter will be dealing with only one Export Factor irrespective of the number of Countries involved .The exporter can obtain valuable information on the standing of the foreign buyers on trade

Customs and market potential in order to expand his business The following up of receivables by import factor will speed up the collections Usually, as factors provide finance up to 90%onexport invoices, the exporter has an improved cash flow and his liquidity improves markedly

Benefits to Importers :

Benefits to Importers He can pay invoices in the country locally He deals with the local agency, i.e. the Import Factor Minimum documentation required The cost of Letters of Credit and delay on account of LC‟s are eliminated. All communication is in his own language.

Points of Difference	**Factoring**	**Forfeiting**
Extent of Finance	Usually 75 – 80% of the value of the invoice	100% of Invoice value
Credit Worthiness	Factor does the credit rating in case of non-recourse factoring transaction	The Forfaiting Bank relies on the creditability of the Availing Bank
Services provided	Day-to-day administration of sales and other allied services	No services are provided
Recourse	With or without recourse	Always without recourse
Sales	By Turnover	By Bills

Forfaiting Services in India

- Recognizing the utility of Forfaiting services to Indian exporters, the RBI decided to makeavailable such services to the exporters.
- At the beginning the RBI authorized EXIM Bank in1992 to offer Forfaiting services. The roleof the EXIM Bank has been that of a facilitator between the Indian exporter and theoverseas Forfaiting agency.

Module 5:
Underwriting

Concept-Devolvement-Business model-Under wring in fixed price offers and book built offers.

Venture Capital: Concept, features, Origin and the current Indian Scenario. Private equity-Investment banking perspectives in private equity

Microfinance-The paradigm-NGOs and SHGs-Microfinance delivery mechanisms-Future of micro finance.

Underwriting

Underwriting is an agreement, entered by a company with a financial agency, in order to ensurethat the public will subscribe for the entire issue of shares or debentures made by the company.The financial agency is known as the underwriter and it agrees to buy that part of the companyissues which are not subscribed to by the public in consideration of a specified underwritingcommission. The underwriting agreement, among others, must provide for the period duringwhich the agreement is in force, the amount of underwriting obligations, the period within whichthe underwriter has to subscribe to the issue after being intimated by the issuer, the amount ofcommission and details of arrangements, if any, made by the underwriter for fulfilling theunderwriting obligations. The underwriting commission may not exceed 5 percent on shares and2.5 percent in case of debentures.

Types of Underwriting

- **Syndicate Underwriting**: - is one in which, two or more agencies or underwriters jointlyunderwrite an issue of securities. Such an arrangement is entered into when the total issueis beyond the resources of one underwriter or when he does not want to block up largeamount of funds in one issue.
- **Sub-Underwriting**:- is one in which an underwriter gets a part of the issue furtherunderwritten by another agency. This is done to diffuse the risk involved in underwriting.
- **Firm Underwriting**: - is one in which the underwriters apply for a block of securities.Under it, the underwriters agree to take up and pay for this block of securities as ordinaryubscribers in addition to their commitment as underwriters.

Role of Underwriters

- The **primary role** of the underwriter is to purchase securities from the issuer and resell them to investors.
- Underwriters act as **intermediaries** between issuers and investors, providing for an efficient of capital.
- The underwriters take the risk that it will be able to resell the securities at a profit.
- Perhaps the most visible and familiar element of the initial public offering process is theunderwriter. The **underwriter is the organization that is actually responsible for**
- **pricing, selling, and organizing the issue**, and it may or may not provide additionalservices.With direct public offerings, there is no need for an underwriter.Selection of a good underwriter is of the utmost importance, but it's important tounderstand that many underwriters are equally selective of their clients. Because anunderwriter's reputation depends onsuccessful issues, few firms will be willing to staketheir reputation on questionable companies.

- When selecting an underwriter, it's important to seek out anestablishedcompanywithagoodreputation and quality research coverage in your field. Thedecision may alsodepend on the kind of agreement the underwriter is willing to makeregarding the sale ofshares. For profitable and established private companies, it shouldn't be difficult to locatean underwriter willing to make a firm commitment arrangement. Under such anagreement, the underwriter agrees to buy all issues shares, regardless of ability to sellthem at a particular price.
- For riskier or less established companies, an underwriter may offer best effortsarrangement for the initial public offering. A best efforts contract requires the underwriterto buy only enough shares to fill investor demand. Under this arrangement, theunderwriter accepts no responsibility for unsold shares

Insurers' business model can be simplified to a simple equation as follows
Profit = earned premium + investment income - incurred loss - underwriting expenses
Insurers can make money in two ways as follows

- Through underwriting, the process by which insurers select the risks to insure and decidehomuch in premiums to charge for accepting those risks
- By investing the premiums they collect from insured parties.
- The most complicated aspect of the insurance business is the underwriting of policies.Using a wide assortment of data, insurers predict the likelihood that a claim will be madeagainst their policies and price products accordingly. To this end, insurers use actuarialscience to quantify the risks they are willing to assume and the premium they will chargeto assume them. Data is analyzed to fairly accurately project the rate of future claimsbased on a given risk. Actuarialscience uses statistics and probability to analyze the riskassociated with the range ofperils covered, and these scientific principles are used todetermine an insurer's overall exposure. Upon termination of a given policy, the amountof premium collected and the investment gains thereon minus the amount paid out inclaims is the insurer's underwriting profit on that policy. Of course, from the insurer'sperspective, some policies are "winners and some are "losers", insurance companiesessentially use actuarial science to attempt to underwrite enough “winning" policies to Pay out on the "losers" while still maintaining profitability.
- An insurer's underwriting performance is measured in its combined ratio. The loss ratio isadded to the expense ratio to determine the company's combined ratio. The combinedratio is a reflection of the company's overall underwriting profitability. A combined ratioof less than 100percent indicates underwriting profitability, while anything over 100indicates an underwriting loss.
- Insurance companies also earn investment profits on “float”. “Float” or available reserveis the amount of money, at hand at any given moment, that an insurer has collected ininsurance premiums but has not been paid out in claims. Insurers start investing insurancepremiums as soon as they are collected and continue to earn interest on them until claimsare paid out. The Association of British Insurers

Underwriting in fixed price offers:
Underwriting is an optional for a fixed price offer. Therefore, if an issuer accompany feels thatthe issue is strong enough to sell on its merits, it may decide to take the risk and opt for notunderwriting it. In such case, the company only pays brokerage for marketing its securities toinvestors and saves on underwriting commission. The underwriting decision is normally takenonconsultation with the lead manager who has a good understanding of the market.The

regulations further stipulate that if a fixed price offer is undertaken, the lead manager(s)managing the issue shall undertake a minimum obligation of 5% of the total underwritten amountor Rs. 25 lakh whichever is lower. This regulation suppose that instipulating a mandatoryparticipation of lead manager in the underwriting risk of the issue, a sense of responsibilitywould be included to bring quality issues to the market.

Underwriting in book built offers:

Underwriting is compulsory in book built offers to the extent of the NPO and the issuer company does not have any discretion therein. Therefore, if a company opts for 100% book building route, underwriting has to be done by the book runners and the syndicate members. However, this requirement does not apply to issues where in 50% of the NPO has to be mandatorily allotted to QIBs. In such issues, only the balance portion of NPO, shall be subject to mandatory underwriting.

In book built offers, the book runner assumes the responsibility for the overall underwriting. In case there is more than one book runner, the interse allocation among the book runners determines the extent of their obligation. The book runner(s) enter in to underwriting agreement with the issuer company. In case of under subscription in the issue, it develops on the book runners.

Venture Capital

Venture is a course of proceeding associated with risk, the outcome of which is uncertain.Capital means resources to start the business.Venture Capital can be defined as the "Long-term equity investments in the business whichdisplay a potential for significant growth and financial return".

Features

- Supporting Entrepreneurial Talent by providing finance.
- Providing Business Management Skills.
- A return in the form of Capital Gains.

Origin:

In India, the need for VC was recognized in the 7th five year plan and long term fiscal policy ofGOI. In 1973 a committee on Development of small and medium enterprises highlighted theneed to faster VC as a source of funding new entrepreneurs and technology. VC financing reallystarted in India in 1988 with the formation of Technology Development and InformationCompany of India Ltd. (TDICI)-promoted by ICICI and UTI.The first private VC fund was sponsored by Credit Capital Finance Corporation (CFC) andpromoted by Bank of India, Asian Development Bank and the Commonwealth DevelopmentCorporation viz. Credit Capital Venture Fund. At the same time Gujarat Venture Finance Ltd.and APIDC Venture Capital Ltd. were started by state level financial institutions. Sources ofthese funds were thefinancial institutions, foreign institutional investors or pension funds andhigh net-worth individuals. Though an attempt was also made to raise funds from the public andfund new ventures, the venture capitalists had hardly any impact on the economic scenario forthe next eight years.

Current Indian Scenario:

The Growth of Silicon Valley Slow Growth in 1960s & early 1970s, and the First Boom Year in1978: During the 1960s and 1970s, venture capital firms focused their investment activityprimarily on starting and expanding companies. More often than not, these companies wereexploiting breakthroughs in electronic, medical or data-processing technology. As a result,venture capital came to be almost synonymous with technology finance. Venture capital firmssuffered a temporary downturn in 1974, when the stock market crashed and investors were

naturally wary of this new kind of investment fund.1978 was the first big year for venturecapital. The industry raised approximately $750,000 in 1978.Highs & Lows of the 1980s: In 1978, the US Labor Department reinterpreted ERISA legislationand thus enabled this major pool ofpension fund money to invest in alternative assets classessuch as venture capital firms. Venture capital financing took off. 1983 was the boom year - thestock market went through the roof and there were over 100 initial public offerings for the firsttime in U.S. history. That year was also the year that many of todays largest and most prominentVC firms were founded. Due to the excess of IPOs and the inexperience of many venture capital
fund managers, VC returns were very low through the 1980s.VC firm retrenched, working hard to make their portfolio companies successful. The work paidoff and returns began climbing back up. The dot com boom: The late 1990s were a boom timefor the globally-renowned VC firms on Sand Hill Road in the San Francisco Bay Area. Anumber of large IPOs had taken place, and access to "friends and family" shares was becoming amajor determiner of who would benefit from any such Common investors would have had nochance to invest at the strike price in this stage.The NASDAQ crash and technology slump that started in March 2000 shook some VC fundssignificantly by the resulting disastrous losses from overvalued and non-performing startups. By2003 many firms were forced to write off companies they had funded just a few years earlier,and many funds were found "under water"; (the market value of their portfolio companies wereless than the invested value).Venture capital investors sought to reduce the large commitmentsthey had made to venture capital funds. By mid-2003, the venture capital industry would shrivelto about half its 2001 capacity. Nevertheless, PricewaterhouseCoopers Money Tree Surveyshows that total venture capital investments hold steady at 2003 levels through the second quarter of 2005.

Stages of Investments

Early stage companies

- Early stage companies may have **proprietary technology** or intellectual property that has the potential to be exploited on a global scale. The technology or lead product is usually beyond proof of principle stage
- **Mid-stage companies** may have strong pipeline of technologies and products, which hasbeen developed by research and management teams with scientific and commercialcredibility
- **Later stage companies** have operational and corporate finance skills ideally positionedand company may need investments to precipitate consolidations. Companies at this stageare within 12 to 18 months of an IPO.

Stages in Venture Capital Financing

Seed stage Financing

The venture is still in the **idea formation stage** and its product or service is not fullydeveloped. The usually lone founder/inventor is given a small amount of capital to come upwith a workingprototype. It is spent on marketing research, patent application, incorporation,and legal structuring for investors. It's rare for a venture capital firm to fund this stage. Inmost cases, themoney must come from **the founder's own pocket**, from the & quot; 3 Fs " **(Family, Friends, and Fools**), and occasionally from angel investors.

First -stage financing

The venture has finally launched and achieved initial traction. **Sales are trending upwards**.A management team is in place along with employees. The funding from this stage is used tofuel sales, reach the **breakeven point**., **increase productivity, cut unit costs**, as well asbuild the corporate infrastructure and distribution system. At this point the company is two tothree years old.

Second -stage financing Sales at this point are **starting to snowball**. The company is also rapidly accumulatingaccounts **receivable and inventory**.

Capital from this stage is used for funding expansion in all its forms from meeting increasingmarketing expenses to entering new markets to financing rapidly increasing accountsreceivable. Venture capital firms specializing in later stage funding enter the picture atthispoint. **Mezzanine or Bridge financing**At this point the company is a **proven winner and investment bankers have agreed totake it public within 6 months.** Mezzanine or bridgefinancing is a short term form offinancing used to prepare a company for its IPO. The funding may come from a venturecapital firm or bridge financing specialist. They are usually paid back from the proceeds ofthe IPO.

Initial Public Offering (IPO)

The company finally achieves liquidity by being allowed to have its stock **bought and soldbythe public**. Founders sell off stock and often go back to square one with another startup.Please notethat some companies have more financing stages than shown above and othersmay have fewer. Very few reach the bridge and IPO stages. It all depends on the individual company.

Types of Venture Capital financing

Equity Participation:

- Generally doesn"t exceed 49% of the total equity. Overall control remains with theentrepreneur. Venture Capitalists earn Capital Gains when the shares are ultimatelydisposed off, say after 5 to 8 years.

conditional Loan

- Royalty Charges - Normally ranges between 2 – 15% as the cost of financing, InterestPayments High interest rate around 20 – 25% , These Payments are made once thefirm secure its commercial confidence, strength and viability in the market.
- **Income Notes** It is a compromise between conventional loan and conditional loans. To
- pay both interest and royalty on sales but at substantially low rate.

Participating Debentures: Operation below minimum level – No interest Operation

- above minimum level – low interest rate Operation in full swing – High interest rate

Investment banking perspectives in private equity

Private equity firms, on the other hand, are groups of investors that use collected pools ofcapitalfrom wealthy individuals, pension funds, insurance companies, endowments, etc. to invest in businesses. Private equity funds make money from a) convincing capital holders to give themlarge pools of money and charging a % on these pools and b) generating returns on theirinvestments. They are investors, not advisors.

The two business models do intersect. Investment banks (often through a dedicated group withinthe bank focused on financial sponsors) will pitch buyout ideas with the aim of convincing a PEshop to pursue a deal. Additionally, a full-service investment bank will seek to providefinancing for PE deals.There is less standardization in private equity – various funds will engage their associatesindifferent ways, but there are several functions that are fairly common, and privateequityassociates will participate in all these functions to some extent. They can be boiled down into four different areas:

- Fundraising

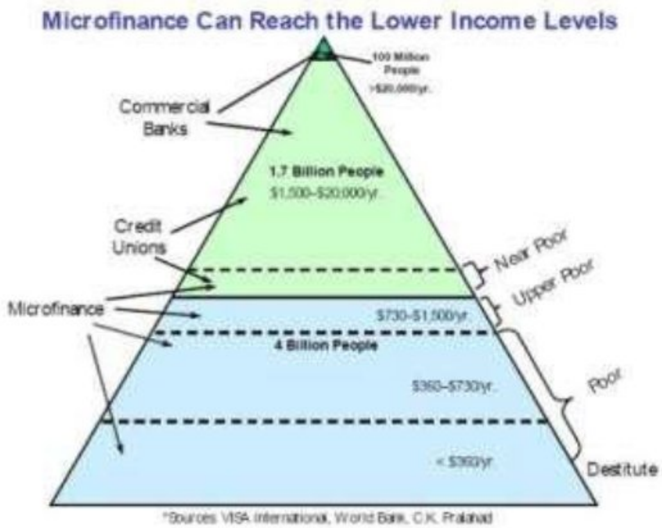
- Screening for and making investments
- Managing investments and portfolio companies
- Exit strategy

Micro finance:

A type of banking service that is provided to unemployed or low-income individuals or groupswho would otherwise have no other means of gaining financial services. Ultimately, thegoal ofmicro finance is to give low income people an opportunity to become self-sufficient by providing a means of saving money,borrowing money and insurance.

Scenario of Micro Finance in India

India„s population is more than 1200 million, around 350 million, are living below the poverty, only 20% access loan from the formal sources and 80% from the informalsources. Out of that 20% only 10% have access to Micro finance. Annual credit demand by thepoor is estimated to be about Rs 60,000 crores. And only 12,000 crores are disbursed. (April 09)Customers of Micro Finance are-Small and marginal farmers", " rural artisans" and"economically weaker sections



The Repayment Mechanism:

- One year loan.
- Equal weekly installments.
- Repayment starts one week after the loan.
- Repayment amounts to 2% per week for fifty weeks.

The Self Help Group (SHG):

SHGs is a small group of rural poor, who have voluntarily come forward to form a group forimprovement of the social and economic status of the members. Homogeneous group of about 15to 20. Every member to save small amounts regularly. Every member learns prioritization and financial discipline.

Condition required for membership for SHG‘s:

- Members should be between the age group of 21-60 years. From one family, only oneperson can become a member of an SHG. (More families can join SHGs this way).
- The group normally consists of either only men or only women.
- Members should be homogenous i.e. should have the same social and financial Background.

- Members should be rural poor

Micro Finance delivery mechanisms

State Bank of India

The State Bank of India (SBI) gives wholesale loans to NGOs and MFIs, in addition to its direct self-help group business. So it is involved in both direct and indirect microfinance delivery methods.SBI is the world‟s largest bank by numbers employed and numbers of branches. In March 2004its total advances were $30 billion, of which $7.8 billion was lent for farming and small-scaleindustry, the so-called „priority sectors‟ for which all commercial banks in India are required tolend a fixed proportion of their portfolio.SBI has been involved in India‟s poverty alleviation programmes and has suffered heavy lossesas a result but the Bank has also entered the rapidly growing self-help group (SHG) market. In2004, SBI was lending to 175,000 SHGs, with over two million women members; approximately another 175,000 groups have savings accounts with the Bank and are likely to take loans in the near future. The interest rate is about 10% and recoveries are almost perfect. Only about 25% of SBI‟s branches are involved in direct business with SHGs, however. The others are not involved,either because of competition from other banks or MFIs, or because there are no local NGOs topromote groups, or because local management are unenthusiastic.In areas where MFIs dominate the market, however, SBI has become involved in bulk lending toa number of strong MFIs. One such MFI is SKDRDP, which is based on a very wealthy Hindutemple which also has a social outreach programme. The MFI needed $3.15 million and asked 21banks to tender for the loan. Twelve banks submitted tenders and the manager of the local SBIbranch was particularly keen because his bank had thus far not secured any other business fromSKDRDP. He submitted a bid at 8.15% and it was accepted. The loan counts towards SBI‟spriority sector target and is informally secured by the temple‟s assets. This form of indirectmicro-finance business is growing faster than SBI‟s direct SHG business and some SBImanagement believe that this is the best way for the Bank to reach the poor.

ICICI Bank in India

ICICI Bank is involved in a mix of indirect methods of microfinance.

The present ICICI Bank is the second largest bank in India in financial terms. It was formedin2002 by a merger between its original parent, a development finance institution, and itssubsidiary bank. ICICI Bank‟s shares are widely held and are quoted on the New York stockexchange. The newly enlarged bank had to increase its priority sector portfolio as a matter ofurgency, since this obligation had not applied to the original parent. Management took this as anopportunity and they devised a range of models for engaging with microfinance. By 2004 their microfinance portfolio had reached a total of $40 million.Over 90% of this portfolio is under the partnership model, whereby the Bank carries the microfinanceloans in its own books but it subcontracts the origination, management and recovery ofthe loans to an NGO or MFI. Under its other model, the Bank buys the micro-finance portfolifrom the MFI, either on a package basis or by buying the complete loan book of a branch or area at one time, or on an on-tap basis, continuously taking over the loans as they are made.In either case, the Bank reduces its risk by some form of first loss guarantee. A third party mayguarantee an agreed percentage of the amount outstanding, or the Bank may extend an overdraftlimit to the MFI for an agreed percentage of the amount, which is only drawn down in case ofdefault, or the MFI may lodge its share of the transaction margin with the Bank until such timeas the loans are repaid. ICICI Bank has also made a small equity investment in BASIX Finance,one of the MFI from which it has purchased a part of its portfolio.The Bank also has a modest but growing direct micro-finance portfolio through its ownbranches. It plans in due course to securitise and sell on its micro-finance portfolio, and thus tocreate a secondary market in this form of debt. ICICI Bank believes that its micro-finance portfolio will reach $4 billion within a few years and such a secondary market would, of course, be of great value to other financial institutions and thus to other MFI and their clients.

Projections for the future Micro finance in India

- Annual growth rate of about 20 % during the next five years.
- 75 % of the total poor households of 80 million (i.e. about 60 million will be reached in the next five years. Industry is expanding significantly,
- MFIs popular among European pension and other institutional funds,
- One of the few financial sectors not significantly affected by the current recession,
    - Excellent diversification possibilities.

Module 6
Leasing

Concept, Steps in Leasing Transactions, Types of Lease, Legal frame works, Advantages and disadvantages of Leasing, Contents of a Lease Agreement, Matters on
Depreciation and Tax, Problems in leasing, Factors influencing Buy or Borrow or Lease Decision.

Hire Purchasing: Concepts and features, Hire Purchase Agreement, Comparison of Hire Purchase with Credit sale, Instalment sale and Leasing. Banks and Hire Purchase. Problems related to outright purchase, Hire purchase and Leasing.

Meaning of Leasing

Lease is a form of contract transferring the use or occupancy of land, space, structure or equipment in consideration of a payment usually in the form of a rent.

Lessor

Lessor is a person who conveys to other person (Lessee) the right to use of the asset in consideration of payment periodically under lease agreement.

Lessee

Lessee is a person who obtains from the lessor to use of the asset in periodically under lease agreement.

Steps in lease agreements

Step 1. Defining Your Requirements

The first step in the leasing process is to determine your list of requirements. What is your budget? Where do you want to live, near bustling downtown, in a community like Tarrytown or on the shores of the Lake Austin? What type of property appeals to you most, a house, duplex, condo or apartment? How many bedrooms and bathrooms will you need?

Step 2. Searching for Properties

If you want to begin your property search online, CarvajalGroup.com is a great place to start. We've worked hard to ensure that our search engine is fast, intuitive, and most importantly, up to date. Click on search; select the "Leases" box on the left-hand side and the property types you want to consider on the right-hand side, along with your ideal price, size and location. You'll seeall of the properties that meet your requirements with detailed information, pictures, virtual tours and more. Then save your favorites to your shopping cart.

Step 3. Finding Your Ideal Property

Once you've narrowed down your list to a handful of good matches (after throwing out that house that looks like it was last updated in 1920 and all the other properties you just didn't like the look of for one reason or another), it's time schedule showings with your agent. Pictures are one thing, but you'll want to see your prioritized properties in person, take notes and compare. Which property best suits your needs? It's up to you to answer, but we'll be with you every step of the way to help with questions and details.

Step 4. Submit Your Lease Offer or Apartment Application

Once you've found your ideal property, you'll need to submit a lease offer for houses/duplexes/condos or rental application for apartments. Don't worry; it's not a daunting process. Credit and background checks will likely be completed during this part of the process, so let your agent know up front if there are any issues that may arise. We'll work through these in advance so that when you find the right place, everything proceeds like clockwork.

Step 5. Sign Your Lease

Leases are binding contracts, so we'll want to make sure to go over the fine print. What day of the month is your rent due and is there a grace period? Who should you contact for repairs? Will your lease automatically renew without written notice? You'll need to pay any necessary deposits and often the first month's rent. When everything is signed and the deal is done, file a copy of your lease somewhere safe to refer to later.

Step 6. Walk-Through and Move-In

Want that deposit back? Before you move in, you walk through the property and note any issues. We'll make sure you submit the appropriate form so your landlord will make any immediate repairs necessary and so that you will not be heeld responsible for any major flaws upon move out.

Types of lease financing

- **Financial lease**

It is also known as capital or long term lease. Here, the lessee selects the equipments, settles the price and terms of sale and arranges with a leasing company to buy it. He enters into an irrevocable and non-cancellable contractual agreement with the leasing company. The lessee uses the equipment maintains it, insures and avails the after sales service and warranty backing it. It provides for periodic rental payments during this period which are calculated on the basis of Return of the original investment in the asset to the investor. The cost of insurance, maintenance and other related expenses are debited to the account of the lessee.

- **Operating lease**

An operating lease is a short term lease where the contractual period between the lessor and lessee is lessor than the expected economic life of the equipment. The lease can be terminated by giving stipulated notice as per the agreement. The rentals are generally higher as compared to other leases on account of short period of primary lease. The risk of obsolescence is enforced on the lessor who will also bear the cost of maintenance and other relevant expenditure. The lessor also does the services like handling warranty claims, paying taxes, scheduling and performing maintenance and keeping complete records lease in suitable for computers, material handling equipment, vehicles, etc, which becomes obsolete soon.

- **Sale and lease back**

A firm which has an asset sells it to the leasing company and gets it back on lease. The asset is generally sold at its market value. The firm receives the sale price in cash and gets the right to use the asset during the lease period. The firm makes periodical rental payment to the lessor. The title to the asset vests with the lessor. Most of the lease back agreements are on a net basis which means that the lessee pays all maintenance expenses, property taxes and insurance. The lease agreement allows the lease to repurchase the property at the termination of lease, retail stores, office building, multipurpose industrial building and shopping centers are financed under this method.

- **Direct lease**

A direct lease in one which is not a sale and lease back transaction. A direct lease can be of two types namely bipartite lease and tripartite lease.

A bipartite lease in one where there are two parties to the transaction i.e. equipment supplier cum lessor and the lessee. It functions like an operating lease with built in facilities like up gradation of the equipment‟s in the original equipment configuration. The lessor undertakes to maintain the

equipment and even replaces the equipment that is in need of major repair with the similar functioning equipment. All these add ones to the lease agreement are possible as the lessor is the manufacturer and dealer of the equipment covered by lease.

A tripartite lease is one that involves three different parties i.e. the equipment supplier, the lessor and the lessee. Most of the equipment lease transactions fall under this category. A variant of this type of lease is the sales aid lease, where the equipment supplier arranges for lease finance where the customer is short on liquidity.

- **Leveraged lease**

A leveraged lease is used for financing those assets which require huge capital outlay. The outlay for purchase cost of asset varies from Rs.50 lakhs to Rs.2 crore and has an economic life of more than 10 years. It involves three parties namely the lessee, the lessor and the lender. The lessor acquires the asset as per the terms of the lease agreement but finances only a part of the total investment say 20% to 50%. The balance is provided by a person or a group of persons in the form of loan to the lessor. The leverage lease includes railway lines, electricity generating plants, pipelines, ships, etc.

- **Cross border leasing**

Cross border leasing is international leasing and is known as transnational leasing. It relates to a lease transaction between a lessor and lessee domiciled in different countries and includes export leasing.

- **Consumer leasing**

Consumer leasing is leasing of consumer durables such as television, refrigerators, etc.

- **Balloon leasing**

A type of lease, which has zero residual value at the end of the lease period, is called „Balloon Lease‟. It also means a kind of a lease where the lease rentals are low at the inception, high during the mid years and low again during the end of the lease.

Legislative framework

As there is no separate statute for equipment leasing in India, the provisions relating to bailmentin the Indian Contract Act govern equipment leasing agreements as well Section 148 of the

IndianContract Act defines bailment as:

"The delivery of goods by one person to another, for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed off according to the directions of the person delivering them. The person delivering the goods is called the „bailor‟ and the person to whomthey are delivered is called the „bailee‟.

Since an equipment lease transaction is regarded as a contract of bailment, the obligations of the lessor and lessee are similar to those of the bailor and the bailee (other than those expressly specified in the least contract) as defined by the provisions of sections 150 and 168 of Indian Contract Act. Essentially these provisions have the following implications for the lessor and the lessee.

The lessor has the duty to deliver the asset to the lessee, to legally authorize the lessee to use the asset, and to leave the asset in peaceful possession of the lessee during the currency of the agreement.

The lessee has the obligation to pay the lease rentals as specified in the lease agreement, to protect the lessor‟s title, to take reasonable care of the asset, and to return the leased asset on the expiry of the lease period.

Income Tax Provisions relating to leasing

The tax treatment of lease transactions in India is based on whether the lease qualifies as a lease or will be treated as hire purchase transactions. If the transaction is treated as a lease, the lesser shall be eligible for depreciation on the asset. The entire lease rentals will be taxed as income of the lessor. The lessee correspondingly will not claim any depreciation and will be entitled to expense off the rentals.

If the transaction is hire purchase or conditional sale transaction, the hirer will be allowed to claim depreciation. The financing charges inherent in hire installments will be taxed as the hire vendor‟ s income and allowed as the hirer ' s expense. Leasing has tax implications and offers the benefits as well to the lessor and the lessee. They can avoid or reduce tax liability and share tax incentives can be transferred from the lessor and the lessee in leasing. For a business the lease rentals income is taxable under income from business and profession while in case of others it is taxed as income from other sources as per the income tax act, 1961.

- The lessee can claim lease rentals as tax deductable expenses.
- The lease rentals received by the lessor are taxable under the head profit from business.
- The lesser can claim investment allowance and depreciation on investment on leased asset.

Advantages of Leasing

- Leasing is inflation friendly. As the costs go up over five years, you still pay the same rate as when you began the lease, therefore making your dollar stretch farther. (In addition, the
- lease is not connected to the success of the business. Therefore, no matter how well the
- business does, the lease rate never changes.)
- There is less upfront cash outlay; you do not need to make large cash payments for the
- purchase of needed equipment.
- Leasing better utilizes equipment; you lease and pay for equipment only for the time you
- need it.
- There is typically an option to buy equipment at end of lease term.
- You can keep upgrading; as new equipment becomes available you can upgrade to the latest
- models each time your lease ends.
- Typically, it is easier to obtain lease financing than loans from commercial lenders.
- It offers potential tax benefits depending on how the lease is structured.

Disadvantages of leasing: Leasing is a preferred means of financing for certain businesses. However it is not for everyone. The type of industry and type of equipment required also need to be considered. Tax implications also need to be compared between leasing and purchasing equipment.

- You have an obligation to continue making payments. Typically, leases may not be terminated before the original term is completed. Therefore, the renter is responsible for paying off the lease. This can pose a major financial problem for the owners of a business experiences a downturn.
- You have no equity until you decide to purchase the equipment at the end of the lease term,
- at which point the equipment has depreciated significantly.
- Although you are not the owner, you are still responsible for maintaining the equipment as

- specified by the terms of the lease. Failure to do so can prove costly.

Deductibility of Expenses

Certain expenses are allowed to be deducted arrive at the taxable income while computing the income of the lessor. They are Rent, rates and taxes along with repairs and insurance of the leased asset where the expenses are incurred by the lessor

- All expenses incurred in relation to business of leasing.
- Entertainment expenses as per the prescribed limit.
- Depreciation of equipment leased.
- Travel expenses as approved.
- Interest on capital borrowed for the purpose.

Factors influencing Buy or Borrow or Lease Decision

Decision Factors	Lease	Buy
Availability of Suitable Space	Suitable rentals available, competitive market	Suitable facility available for sale, priced within appraised values
Urgency of Need	Immediate to 6 months	6 months -2 years
Duration of Need	Unknown, short term, or long term	Long term
Flexibility	Program is expected to expand or contract over time	Space needs are expected to be constant - either for proposed program, or future needs
Location	Near existing program, or proximity is not essential, or particular offcampus location is desirable	Within Master plan, near existing program, location is highly desirable, or proximity is not essential
Services	Services provided by landlord or	Services available in the vicinity or to

Factors that support each option

Lease:

- Program is of short or unknown duration
- Funding is only available for a short period or a capital investment is not desired
- Suitable facility is available for lease
- Space need is urgent
- Flexibility is needed for future contraction or expansion of space
- Costs for rent, common area expenses, build-out or modifications, and services a reasonable and within budget

Buy:

- Definite long term need for program or general campus use
- No appropriate University or leased space is available
- Facility is available for a reasonable price
- Location and size (including possible program expansion) is suitable

- Acquisition, build-out, moving and maintenance costs are within budget
- Funding source is identified for initial cost or duration of payments
- Property can be acquired in time to meet the needs of the program
- Within the Master Plan

Leasing	Buying
Like to drive a new vehicle every few years and do not want to worry about any major repairs or maintenance expenses	Travel extensively (i.e. more than the standard 24,000 km/a) and do not wish to incur any excess km charges
Prefer lower monthly payments although they become part of your on-going expenses if you continue to lease a vehicle	Do not want any hidden fees or potential charges (such as excess wear and tear) at the end of the lease
Prefer lower monthly payments and invest the difference in a diversified portfolio	Prefer to pay off your vehicle and enjoy it for a long period of time
Want to have flexibility with respect to returning or buying the vehicle at the end of the lease	Want to have flexibility with respect to returning or buying the vehicle at the end of the lease

Hire Purchase

Hire purchase is a method of selling goods. In a hire purchase transaction the goods are let out on hire by a finance company (creditor) to the hire purchase customer (hirer). The buyer is required to pay an agreed amount in periodical installments during a given period. The ownership of the property remains with creditor and passes on to hirer on the payment.

Features of hire purchase

Under hire purchase system, the buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installment.

- Each installment is treated as hire charges.
- The ownership of the goods passes from buyer to seller on the payment of the installment.
- In case the buyer makes any default in the payment of any installment the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charge.
- The hirer has the right to terminate the agreement any time before the property passes. That is, he has the option to return the goods in which case he need not pay installments falling due thereafter. However, he cannot recover the sums already paid as such sums legally represent hire charge on the goods in question.

Hire Purchase Agreement

Hire purchase is the legal term for a contract, in which a purchaser agrees to pay for goods in parts or a percentage over a number of months.

Comparison of Hire Purchase with Credit sale

- Hire Purchase (HP) is an agreement of hire, whereas credit sales are an agreement of sale.
- Ownership of goods is transferred from hire vendor to hire purchaser only when the last installment is paid, but in sales, ownership is transferred immediately to the buyer.
- Price is paid by the hire purchaser through installment which is treated as hire, but in
- sales price is paid in lump-sum or according to the agreement of sale.
- The hire vendor can repossess the goods on default. But in sales the seller cannot take
- back the goods, whatever is the case.

Installment sale and Leasing or Finance Vs Installment Sale

1. **Nature:** Installment sale is a sale whereas lease financing is a type of rental contract with a purchase option between the two parties.
2. **Ownership of the Asset:** In installment sale, the ownership transfers to the user at the end of the installment period. Whereas in case of lease financing, the lessee has to transfer the asset to the lessor after the end of lease period and the lessee has an option to purchase or not to purchase the asset.
3. **Tax Benefits:** The total deduction for taxation purpose is same for leasing and installment sale. However, in case of leasing, it takes twice as long to write off the asset as compared to installment sale. The depreciation is claimed by the lesser in lease financing whereas in installment sale, the user claims the depreciation.
4. **Balance Sheet Appearance:** In lease financing, the value of the asset is not included in the financial statements since the lessee is not the owner. Whereas in case of installment sale, the installments are capitalized i.e. the asset appears in the asset side of the balance sheet and a corresponding liability against such asset appears on the liability side.
5. **Overall Cost of the Asset:** The cost of the asset in case of lease financing is the cost of using the asset over its life. In case of installment sale, installment includes principal amount and the interest for the term till the last installment is paid.
6. **Duration:** Generally leasing is suitable for longer periods and for assets like land, property, heavy vehicles and huge plant and machineries. Installment sale is done for short periods and for assets like light moving vehicles, electrical items, small machineries etc.
7. **Maintenance Support of the Asset:** In case of operating lease financing, the repairs and maintenance for the asset is borne by the lessor and in case of financial lease it is borne by the lessee. In installment sale, the responsibility lies with the user.
8. **Reduced Initial Cash Outlay:** Since there is no immediate purchase of asset in installment sale, the cash flow is limited up to the margin money i.e. the down payment or the deposit as it is so called in addition to the periodic installments. In case of lease financing, the monthly rentals are the only cash flows during the entire usage life of the asset.

Banks and Hire Purchase

1. **Ownership:** In hire purchase, the seller/financier owns the asset until the buyer makes the final payment and hence the word “Hire” is used. Whereas in term loan, the buyer borrows money, pays for the asset, and own it immediately. So, in case of hire purchase, one cannot sell the asset if he runs into problems making periodic payments but in term loan, it can be sold.
2. **Cost of the Asset:** The cost of the asset in case of term loan is the cost at which the buyer purchases + installation cost if any, whereas in case of hire purchase, the cost to the buyer is

normal cash price + HP Interest. The interest cost is incurred in case of term loan also but that forms part of finance cost of the company and is not capitalized with the asset.

3. **Repossession of the Hired Asset:** It may happen that the buyer is unable to pay all the payments required under the agreement. Once the buyer stops making the installments, the seller/financier has the right to take away the asset. This is called Repossession. In term loan, the borrower can only take away the assets which are provided as security against the loan. Normally, the purchased asset is the primary security of the term loan along with the collateral security. So, the bank or financial institution can take away the underlying asset as well as the collaterals.

4. **Mortgage of Assets in the Form of Security:** No security, in any form, is required for taking an asset on hire. Whereas the borrowers needs to pledge his assets as security in case of term loan.

5. **Financial Statements:** In hire purchase, the value of the asset is not included in the financial statements since the owner is the financier company till the buyer pays the last hire charges installment. Whereas in case of loan, the value of asset appear on the asset side and a corresponding liability for loans against such asset appear on the liability side.

6. **Effect of Taxation:** In both the cases, i.e. when the asset is purchased by loan, or if it is taken on hire, the user of the asset can take deduction on the depreciation of the asset (which decrease every year due to written down value effect) and also for interest on term loan or hire purchase installments. The only difference being in the quantitative amount of interest.

7. **Risk of Holding the Asset:** In case of hire purchase, there is an option called "The Half-Rule" which states that the user can return the asset and terminate the agreement at any time giving the seller/ financier a notice in writing. Whereas in case of loan financing, the user of the asset has to bear all the risk of asset devaluation due to change in technology.

Reverse mortgage

A type of mortgage in which a homeowner can borrow money against the value of his or her home. No repayment of the mortgage (principal or interest) is required until the borrower dies or the home is sold. After accounting for the initial mortgage amount, the rate at which interest accrues, the length of the loan and rate of home price appreciation, the transaction is structured so that the loan amount will not exceed the value of the home over the life of the loan.

Leasing	**Hire Purchase**
Ownership of the property lies with lessor, not transferred to lessee	Ownership of the property is transferred to the hirer on the payment of the last payment.
Lessor, is entitled to claim depreciation tax shield.	The hirer is entitled to claim depreciation tax shield.
Capitalization of the asset is done in the books of lessor	Capitalization of asset is done in the books of hirer.
The entire lease payments are eligible for tax computation in the books of lessee	Only the hire interest is eligible for tax computation in the books of the hirer.
Lessor income declines as the investment o/s in lease declines	Lessor income declines as the investment o/s in lease declines
The lessor has the right to claim the benefit of salvage value	The hirer can claim benefit of salvage value as the owner of the asset

Leasing is used as a source of finance, usually for acquiring high cost assets i.e., machinery, ships, airplanes,etc	H.P is used as a source of finance usually for acquiring relatively low cost assets i.e., automobiles, office equip
No down payment is required for acquiring the use of leased assets.	Down payment is required to be made for acquiring the assets and a margin maintained to the extent of 20-25%
Leased assets are disclosed by way of a note only in the books of lessee	Asset bought on hire purchase will be shown as asset
The lessee has to maintain the leased asset in case of financial lease, up keep is the responsible of lessor in case of operating lease.	The hirer is responsible to ensure the maintenance of asset bought
Not suitable for low capital enterprises	It is highly suitable for low capital enterprises which need to show a strong asset position in their balancesheet
An asset given by a leasing company is treated as fixed asset of lessor	The hire vendor normally shows the asset let under HP either as stock in trade or receivables
All receipts from lessee is taken into lessor p&l a/c	Only interest portion is taken into vendor p&l a/c

Legal Position

The Hire Purchase Act, 1972 defines a hire purchase agreement as, an agreement under which goods are let on hire and under which the hirer has an option to purchase them in accordance with the terms of agreement under which:

- Payment is to be made in installments over a specified period.
- The possession is delivered to the purchaser at the time of entering into a contract.
- The property in the goods passes to the purchaser on payment of the last installment.
- Each installment is treated as hire charge so that if default is made in payment of any one installment, the seller is entitled to take away the goods.
- The hirer/purchaser is free to return the goods without being required to pay any further Installments falling due after the return.

Module 7:

Credit rating:

Definition and meaning, Process of credit rating of financial instruments, Rating methodology, Rating agencies, Rating symbols of different companies. Rating agencies for SMEs

Securitization of debt:

Meaning, Features, Special Purpose Vehicle, Types of securities able assets, Benefits of Securitization, Issues in Securitization. Credit rating is the symbolic indicator of the current opinion of the rating agency regarding the relative ability of the issuer of the financial (debt) instrument to meet the (debt) service obligations as and when they arise.

Rating

Rating is defined by the SEBI regulations as an opinion regarding securities, expressed in the form of standard symbols or in any other standardized form, assigned by credit rating agency and used by the issuer of such securities.

Credit rating process

All the four rating agencies in the country adopt a similar rating process. The steps followed by them in the rating process are illustrated with reference to

i) New issues / instruments

ii) Review of rating

i. Rating process of new issues

1. **Rating agreement and assignment of analytical team:** The process of rating starts with the issue of the rating request letter by the issuer of the instrument and the signing of the rating agreement. On receipt of the request, the credit rating agency assigns an analytical team. Comprising two or more analysts, one of whom would be the lead analyst and would serve as the issuer‟s primary contact the analyst who have experience in the relevant business area are responsible for carrying out the rating assignments.

2. **Meeting with management**

Prior to meeting with the issuer, the analytical team obtains and analyses information relating to its financial statements, cash flow projections and other relevant information like annual reports for the past five years, latest prospectus offering statements, consolidated financial statements, existing loan agreement, etc. Discussion with the management might reveal more information as such discussions should cover the following matters:

(a) Discussion on the management might philosophy and plan should cover the financial and operating dates for the past five years and three to five year for future projections.
(b) Discussion on projections should reveal management objectives and future plans, that is future growth plan of the company should be crystallized.
(c) Discussions must help reveal the risks and opportunities that affect credit quality over the period covered under projections.

3. Rating committee:

After meeting with the management, the analysts present their report to a rating committee, which then decides on the rating the relating committee meeting is the only aspect of the process in which the issuer does not participate directly. The rating is arrived at after a composite assessment of all the factors concerning the issuer, with the key issues getting greater attention from the rating committee.

4. Communication to the issuer

After the committee has assigned the rating the rating decision is communicated to the issuer with the reasons or rationale supporting the rating.

5. Dissemination to the public

Once the issuer accepts the rating, the credit rating agency disseminates it, along with the rationale, through the print media.

ii. Rating review for possible change

In the case of rated instruments, the rated company is on the surveillance system of the credit rating agency and from time to time, the earlier rating is reviewed. The credit rating agency constantly monitors all ratings with reference to new political, economic and financial developments and industry trends the following steps are necessary in the rating process for review cases.

1. New data of company

Analysts review the new information or data available on the company, which might be sent to it by the company or it might have been procured through routine channels as strategic information under its surveillance approach. If the new information is crucial for rating decision, then analyst stake action to collect more information as may be available from different sources and study the same from the angle of relevance and authenticity.

Rating change possibility for changing the rating, then the analysts request the issuer for a eeting with its management and proceeds with a comprehensive rating analysis.

3. Credit rating watch

During the review monitoring or surveillance exercise, rating analysts might become aware of imminent events like mergers and so on, which affect the rating and warrants a rating change.

Rating Methodology

The rating methodology involves an analysis of the industry risk, the issuer ' s business and financial risks. A rating is assigned after assessing all the factors that could affect the credit worthiness of the entity. The rating methodology illustrated below with reference to manufacturing companies and financial service companies.

i) Manufacturing companies

The main elements of the rating methodology for manufacturing companies are outlined below.

1. Business risk analysis

The rating analysis begins with an assessment of the company‟s environment focusing on the strength of the industry prospects, pattern of business cycles as well as the competitive factors affecting the industry. The main industry business factor includes

(a) **Business risk:** Nature and basis of competition, key success factors, demand and supply position, structure of industry, government policies, etc.
(b) **Market position of the issuing entity within the industry:** Market share, competitive advantages, selling and distribution arrangements, product and customer diversity, etc.
(c) **Operating efficiency of the Borrowing Entity:** Locational advantages, labour relationships,
(d) cost structure, technological advantages and manufacturing efficiency as compared to competitors and etc.
(e) **Legal position :** Terms of the issue document or prospectus, trustees and their responsibilities, systems for timely payment and for protection against fraud or forgery, etc.

2. Financial risk analysis

After evaluating the issuer‟s competitive position and operating environment, the analysts proceed to analyze the financial strength of the issuer. Financial risk is analyzed largely through quantitative means, particularly by using financial ratios. The areas considered in financial analysis.

(a) **Accounting quality:** Overstatements or understatement of profits, auditors qualifications, method of income recognition, inventory valuation and depreciation policies, off balance sheet liabilities, etc.
(b) **Earnings prospectus:** Sources of future earnings growth, profitability ratios, earnings in relation to fixed income charges, etc.
(c) **Adequacy of cash flows:** In relation to debt and working capital needs, stability of cash flows, capital spending flexibility, working capital management, etc.
(d) **Financial flexibility:** Alternative financing plans in times of stress, ability to raise funds, asset deployment potential, etc.
(e) **Interest and tax sensitivity:** Exposure to interest rate changes, tax law changes, hedgingagainst interest rates, etc.

3. Management risk

A proper assessment of debt protection levels requires an evaluation of the management philosophies and its strategies. The analyse compares the company ' s business strategies and financial plans to provide insights into management abilities with respect to forecasting and implementing of plans.

Financial services sector: When rating debt instruments of financial institutions, bank and nonbanking finance companies, in addition to the financial analysts and management evaluation outlined above the assessment also lays emphasis on the following factors.

a. Regulatory and competitive Environment: Structure and regulatory framework of the financial system. Trends in regulation or deregulation and their impact on the company or institution.

b. Fundamental Analysis

Capital adequacy: Assessment of the true net worth of the issuer, its adequacy in relation to the volume of business and the risk profile of the assets. *Resources:* Overview of funding sources, funding profile, cost and tenor of various sources of
Funds

Asset quality: Quality of the issuer‟s credit risk management; systems for monitoring credit; sector risk, exposure to individual borrowers, management of problem credits, etc. *Liquidity management:* Capital structure, term matching of assets and liabilities, policy on liquidity assets in relation to financing commitments and maturing deposits. *Profitability and financial position:* Historic profits, spreads on funds deployment, revenues on
non-fund based services, accretion to reserves, etc. *Interest and tax sensitivity:* Exposure to interest rate changes, tax law changes, hedging against interest rate.

Credit Rating Agency

Credit rating agency means a body corporate engaged in the business of rating securities.

Credit Rating Agencies

Credit rating agencies is a company that relates the ability of a person or company to pay back loan.

i) CRISIL (Credit rating and Information services of India Ltd)

CRISIL was jointly promoted by ICICI and UTI. Its other shareholders are LIC, SBI, HDFC, etc. In 1995, it entered into a strategic alliance with standard and poor to extend its credit rating services to borrowers from overseas market. The services offered are broadly classified as rating services, information services, infrastructure services and consultancy.

1. Rating services cover rating of debt instruments i.e. long medium and short term.
2. Information services offer corporate research report

3. The infrastructure and consultancy division provides assistance on specific sectors.

ii) ICRA (Investment Information and Credit Rating Agency of India Ltd)

ICRA has been promoted by IFCI and 21 other shareholders comprising foreign and nationalized banks and Indian Insurance Companies. Established in1991, ICRA is the second rating agency in India. Services offered by ICRA are analytical services, advisory services and investment Services.

iii) CARE (Credit Analysis and Research)

CARE was established in 1992 by IDBI jointly with Canara Bank, UTI, Private sector banks and insurance companies. The services offered by CARE include credit rating of debt instruments, credit assessment of companies, advisory services, credit reports and performance ratings.

Credit rating Symbols

ICRA

a. Long term Debt- Debentures, Bonds and Preference Shares
b. **Securitization of debt**
c. Securitization of debt or asset refers to the process of liquidating the illiquid and long term assets
d. like loans and receivables of financial institutions like banks by issuing marketable securities
e. against them.
f. In other words, it is a technique by which a long term, non-negotiable and high valued financial
g. asset like hire purchase is converted into securities of small values which can be tradable in the
h. market just like shares.
i. It is the process of removing long term assets from the balance sheet of a lending financial
j. institution and replacing them with liquid cash through the issue of securities against them.
k. **Features of Securitization**
l. *i) Marketability:* The very purpose of securitization is to ensure marketability to financial claims.
m. Hence, the instrument is structured in such a way as to be marketable. This is one of the most
n. important features of a securitized instrument and the others that follows are mostly important
o. only to ensure this feature. Marketability involves two concepts:
p. The legal and systematic possibility of marketing the instrument
q. b. The existence of a market for the instrument
r. *ii) Merchantable Quality:* To be market acceptable, a securitized product should be of saleable
s. quality. This concept, in case of physical goods, is something which is acceptable to merchants
t. in normal trade. When applied to financial products, it would mean that the financial
u. commitments embodied in the instruments are secured to the investor‟s satisfaction.

v. *iii) Wide distribution:* The basic purpose of securitization is to distribute the product. The extent
w. of distribution which the originator would like to achieve, is based on a comparative analysis of
x. the costs and the benefit that can be achieved. Wider distribution leads to a cost benefit, in that
y. the issuer is able to market the product with lower return and hence lower financial cost to him.
z. But a wide investor base involves the high cost of distribution and servicing.
aa. *iv) Homogeneity:* To serve as a marketable instrument, the instrument should be packaged into
bb. homogenous lots. Homogeneity, like the above feature is a function of retail marketing. Most
cc. securitized instruments are broken into lots affordable to the marginal investor and hence the
dd. minimum denomination becomes relative to the needs of the smallest investor. Shares in
ee. companies may be broken into slices as small as Rs.10 each, but debenture and bonds are sliced

into Rs.100 each to Rs.1000 each. Designed for larger investors, a commercial paper may be in denominations as high as Rs.5, 00,000.

v) Commoditization: Securitization is the process of commoditization, where the basic idea is to take the outcome of this process into the capital market. Thus, the result of every securitization process, whatever might be the area to which it is applied is to create certain instrument which can be placed in the market.

vi) Integration and Differentiation: Securitization is the process of integration and differentiation where the entity that securitizes its assets first pools them together into a common hutch pot (assuming it is not one asset but several assets as is normally the case). This is the process of integration. Then, the pool itself is broken into instruments of fixed documentation. This is the process of differentiation.

vii) De-construction: Securitization is the process of de-construction of an entity wherein, if one envisages an entity ’ s assets as being composed of claims to various cash flow, the process of securitization would split apart these cash flows into different buckets, classify them and sell these classified parts to different investors according to their needs. Thus, securitization breaks the entity into various sub-sets.

Benefits of Securitization

i) Benefits to originator

a) Off-balance sheet financing: Securitization offers an advantage of off-balance sheet funding by allowing for the conversation of an otherwise non-liquid asset into ready liquidity. This allows for better balance sheet management. This also enables faster recovery of funds leading to higher business turnover and profitability.

b) Credit enhancement: Credit enhancement helps make the transaction attractive by means of an investment credit rating for the instrument. Since a variety of factors are taken into consideration for rating, it would give a boost to investor confidence in the newly created market of instruments which have qualitative differences but have been built upon underlying debts.

c) Low costs: Securitization helps reduce the funding cost substantially as compared to conventional fund rising instruments like bonds, debentures and commercial paper.

d) Access to market: Asset securitization enables the originators to access the securities market at

a. debt ratings higher than their own overall corporate ratings through the novel technique of credit enhancement and diversification of risk. For instance, the NSE has announced that it will allow listing of securitized assets. This will definitely help develop an active secondary market and improve liquidity.

ii) Benefits to investor

(a) Multiple new investment instrument for investors to meet their preferences.
(b) Enabling the end-investor to look past the issuing entity to the collateral pool that the issue represents.
(c) Reduction in uncertainty for the investor by minimizing the risk element through transparency.

iii) Benefits to borrowers

Securitization facilitates greater economy in the use of capital. Financial institutions pass the benefits to borrows by providing more funds at lower rates.

iv) General benefits

Securitization by allowing for easy lending and recycling of funds, facilitates effective capital utilization in the economy. Thus the whole economy is benefited through securitization.

Special Purpose Vehicle (SPV)

The entity that intermediates between the originator of the receivables and the end investors is known as „special purpose vehicle‟. Since securitization involves a transfer of receivables from the originator, it would be inconvenient, to the extent of being impossible, to transfer such receivables are as diverse as the investors themselves. Besides, the base of investor could keep changing since the resulting security is essentially a marketable security. Therefore it is necessary to bring in an intermediary that would hold the receivables on behalf of the end investor.

This entity created solely for the purpose of the transaction is called a special purpose vehicle or a special purpose entity, if such entity is a company, special purpose company. The function of the SPV in a securitization transaction could stretch from being a pure conduit or intermediary vehicle, to a more active role in reinvesting or reshaping the cash flows arising from the assets transferred to it, which in turn would depend on the end objectives of the securitization exercise. Therefore, the originator transfers the assets to the SPV, which holds the assets on behalf of the investor and issues to the investors its own securities. For this purpose, the SPV is also called the issuer. In case the securitization involves any asset or claim which needs to be integrated and differentiated unless, it is a direct and unsecured claim on the issuer, the issuer will need an intermediary agency to act as a repository of the asset or claim which is being securitized.

Pass Through Certificate

There is no uniform name for the securities issued by the Special Purpose Vehicle, since such securities take different forms. These securities could represent a direct claim of the investor on all that the SPV collects from the receivables transferred to it. In this case, they are called Pass through Certificate or Beneficial Interest Certificates as they imply certificates of proportional beneficial interest in the assets held by the SPV. Alternatively, the SPV might be re-configuring the cash flows by reinvesting it in order pay the investors on fixed dates, not matching with the dates on which the transferred receivables are collected by the SPV. In this case, the securities held by the investors are called Pay through Certificates. The securities issued by the SPV could also be named based on their risk or other features, such as senior notes or junior notes, floating rate notes, etc.

Key issues in securitization

- Transfer of assets
- True sale of question
- Constitution of Special purpose vehicle
- Equitable transfers