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CHAPTER

CAPITAL MARKET INSTRUMENTS

Question 1] What do you understand by the term 'capital market'?

Ans.: Capital Market is a market for financial investments that are direct or indirect claims to capital. It is wider than the securities market and embraces all forms of lending and borrowing. It is a market, where business enterprises and governments can raise long-term funds. Capital market is wider term and includes security market.

Security market is market where equity shares, preference shares, debentures and bonds are traded. Security market has following two segments:

(a) **Primary Market :** Primary market is that part of the capital markets that deals with the issuance of new securities. Companies, governments or public sector institutions can obtain funding through the sale of a new shares or bond issue. The primary market is the market where the securities are sold for the first time. Therefore it is also called the New Issue Market (NIM).

The issue of securities by companies can take place in any of the following methods:

- Initial public offer
- Further issue of capital
- Rights issue
- Firm allotment
- Offer to public
- Bonus issue

(b) **Secondary Market :** The secondary market, also known as the aftermarket, is the financial market where previously issued securities and financial instruments such as stock, bonds, options, and futures are bought and sold.

The stock market or secondary market ensures free marketability, negotiability and price discharge. Secondary market has further two components:

◆ **Spot Market :** Where securities are traded for immediate delivery and payment.

◆ **Futures Market :** Where the securities are traded for future delivery and payment.

Question 2] Write a short note on: Classification of instruments

Write a short note on: Hybrid Instruments

CS (Executive) – June 2009 (2 Marks), June 2011 (2 Marks)

Ans.: Instruments in capital markets can be classified into three categories: Pure, Hybrid and Derivatives.

(1) **Pure Instruments :** Equity shares, preference shares, debentures and bonds which are issued with the basic characteristics without mixing the features of other instruments are called pure instrument.

(2) **Hybrid Instruments :** Instruments which are created by combining the features of equity, preference, bond are called as hybrid instruments.

Example: Hybrid instruments are:

- Convertible preference shares

- Non-convertible debentures with equity warrant
- Partly convertible debentures
- Secured premium notes

(3) Derivative Instrument : A derivative instrument is a financial instrument which derives its value from the value of some other financial instrument or variable.

Example: Futures and Options belong to the categories of derivatives.

Question 3] Distinguish between: Pure Instruments & Hybrid Instruments

CS (Executive) – Dec 2013 (3 Marks)

Ans.: Following are the main difference between pure & hybrid instruments:

Points	Pure Instruments	Hybrid Instruments
Meaning	Equity shares, preference shares, debentures and bonds which are issued with the basic characteristics without mixing the features of other instruments are called pure instrument.	Instruments which are created by combining the features of equity, preference, bonds are called as hybrid instruments.
Examples	Following are pure instruments: - Equity shares - Preference shares - Debentures	Following are hybrid instruments: - Convertible preference shares - Convertible debentures - Secured premium notes
Beneficial	These are beneficial but not like hybrid instruments.	These are more beneficial than pure instrument.

Question 4] Distinguish between: Debt Market & Equity Market

CS (Executive) – June 2015 (3 Marks)

Ans.: Following are the main difference between debt & equity market:

Points	Debt Market	Equity Market
Meaning	The debt market is the market where debt instruments are traded.	The equity market is the market where equity shares are traded.
Instruments	In debt instruments includes debentures, bonds, Notes & Mortgages.	In equity market equity and preference shares are traded.
Status of holder	Debt instrument holders are creditors of the issuing companies.	Equity holders are the owners of the issuing companies.
Risk	Investments in debt securities typically involve less risk than equity investments.	Investments in equity typically involve more risk than debt investments.
Volatility	Debt market is less volatile.	Equity market is more volatile.
Returns	In debt market there is less risk and hence returns are also low.	Equity market is more risky and may offer attract and higher return as compared to debt market.
Income	Income of debt market is fixed.	Income in equity market is variable.

PURE INSTRUMENTS

Que. No. 5] Write a short note on: Nature of a share

Ans.: Share [Section 2(84)] : A share means a share in the share capital of a company, and includes stock.

Nature of shares & debentures [Section 44] : A share or debentures or other interest of any member in a company is a movable property transferable in the manner provided by the articles of the company.

Numbering of shares [Section 45] : Each share in a company having a share capital shall be distinguished by distinctive number.

Que. No. 6] Write a short note on: Kinds of Shares

Ans.: Kinds of share capital [Section 43(1)] : The share capital of a company limited by shares shall be of two kinds, namely:

(*a*) Equity share capital
- With voting rights
- With differential rights as to dividend, voting or otherwise

(*b*) Preference share capital

Que. No. 7] Explain the term 'equity shares' as per Companies Act, 2013.

Ans.: Equity Shares [Section 43(2)] : Equity share capital with reference to any company limited by shares means all share capital which is not preference share capital.

Question 7A] Explain briefly: Share warrants

CS (Executive) - Dec 2015 (3 Marks)

Ans.: A share warrant is a bearer document of title to shares and can be issued only by public limited companies and that to against fully paid up shares only.

A share warrant is transferable by mere delivery of the warrants without execution of any written instrument of transfer being registered by the company. The bearer of a share warrant is not a member of the company unless otherwise so provided in the articles of the company.

Question 8] An Indian company is planning to issue sweat equity shares of a class of shares already issued. Explain the meaning of sweat equity shares and advise the company regarding the conditions to be fulfilled to issue sweat equity?

CS (Executive) – Dec 2014 (6 Marks)

Write a short note on: Sweat Equity Shares **CS (Inter) – Dec 2005 (5 Marks)**

CS (Executive) – June 2014 (5 Marks)

Ans.: Sweat Equity Shares [Section 2(88)] : Sweat equity shares means equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Issue of sweat equity shares [Section 54] : A company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

(1) The issue has been authorized by a **special resolution** passed by the company in the general meeting.

(2) Such special resolution should clearly specify:
- Number of shares
- Current market price
- Consideration and
- Classes of directors or employees to whom such equity shares are to be issued.

(3) At least 1 year should have elapsed from the date on which the company was entitled to commence business.

(4) A company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the **SEBI (Issue of Sweat Equity) Regulations, 2002**.

(5) A company whose shares are not so listed should comply with the **Companies (Share Capital & Debentures) Rules, 2014**.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued and the holders of sweat equity shares shall rank *pari passu (on an equal footing)* with other equity shareholders. **[Section 54(2)]**

Register of Sweat Equity Shares [Rule 8(14) of the Companies (Share Capital & Debentures) Rules, 2014]: The company shall maintain a Register of Sweat Equity Shares in **Form No. SH. 3** and shall forthwith enter therein the particulars of issue of sweat equity shares.

The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide.

The entries in the register shall be authenticated by the Company Secretary or by any other person authorized by the Board for the purpose.

Que. No. 9] Explain the provisions of the Companies (Share Capital & Debentures) Rules, 2014 relating to Sweat Equity Shares.

Ans.: Provisions of the Companies (Share Capital & Debentures) Rules, 2014 relating to sweat equity shares are as follows:

(1) Explanatory statement to contain certain particulars [Rule 8(2)] : The explanatory statement to be annexed to the notice of the general meeting shall contain the prescribed content like the date of the board meeting; reasons or justification for the issue; the class of shares under which sweat equity shares are intended to be issued; total number of shares; etc.

(2) Validity of special resolution [Rule 8(3)] : The special resolution shall be valid for making the allotment up to period of 12 months.

(3) Limits on issue of sweat equity shares [Rule 8(4)]: The company shall not issue sweat equity shares for more than **15% of the existing paid up equity share capital** in a year or shares of the issue value of **₹ 5 crores**, whichever is higher. The issuance of sweat equity shall not exceed **25%** of the paid up equity capital at any time.

(4) Lock-in-period [Rule 8(5)] : The sweat equity shares issued to directors or employees shall be locked in for a period of **3 years** from the date of allotment and this fact shall be stamped in bold on the share certificate.

(5) Valuation Aspects [Rule 8(6), (7) & (8)] : The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.

The valuation of intellectual property rights or of know how or value additions shall be carried out by a registered valuer.

A copy of the valuation report shall be sent to the shareholders with the notice of the general meeting.

(6) Issue for non-cash consideration [Rule 8(9)] : When sweat equity shares are issued for a non-cash consideration on the basis of a valuation report obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company-

(*a*) Where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or

(*b*) In other cases it shall be expensed as provided in the accounting standards.

(7) Forms part of managerial remuneration [Rule 8(10)] : The amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of Sections 197 & 198, if the following conditions are fulfilled, namely.-

(*a*) The sweat equity shares are issued to any director or manager or