

## PAPER – 6B: FINANCIAL SERVICES AND CAPITAL MARKETS

### Case Study 2

One fine morning Zahir woke with the beep sound of Whatsapp message in his mobile. Half woke up thinking it to be some urgent message from his boss read the message (Exhibit 1) from his one friend Joseph who accidentally sent the same to him instead of Tahir.

Joseph who is lawyer by profession and employed with a leading law firm handling the legal matters listed companies. Last year he was also handling a legal case of Rajendra Holidays.

Since Zahir has no interest in the Stock Market without understanding the message further forwarded the same to his friend Kanjibhai (a jobber in stock market).

A few days later Zahir received a call from Kanjibhai inviting him on a party bash at coming Saturday at one of the 5 Star Hotel of the city. To the utter surprise of Zahir, Kanjibhai who never offered a cup of tea to anyone and always in debt is organizing such a big party. Zahir called back Kanjibhai to know the exact of organizing such party. Kanjibhai expressed there is no special occasion only few of his friends have been invited as a matter of change from daily life.

On Saturday evening Zahir reached the venue of party where other friend were already there. On asking what is reason for this party from all friends, Kanji told he made a huge profit from the stock market and after repaying his old debts now he is buying a small office of his own to work as sub-broker.

During the party after consuming a lot of alcohol Kanji gone out of control and started shouting it is because Zahir who made him rich. Since earlier one or two occasions Kanji had gone out of control after consuming alcohol no one paid heed to his loose talks.

Next morning as a daily routine Zahir was enjoying reading a financial daily. One news (as per Exhibit 2) catches his attention. Although Zahir had no interest in the Stock Market but the amount of penalty was enough to further read the news (as per Exhibit 2).

Further he compiled some of actual information of these listed companies from website. (as per Exhibit 6)

#### Questions

After reading the news he approaches you requesting you to provide him a report on the under-mentioned five questions.

**(A)** Why is it so difficult to monitor messages passed on through WhatsApp? What is the way out to track such messages?

**(B)** What is the meaning of the term 'insider' and 'unpublished price sensitive information' in SEBI Guidelines? What amendments have been made Government to curb the practice of Insider Trading?

**(C)** Whether Joseph can be called as insider trader or not?

**(D)** How the introduction of Automation or Insider Trading Management System (ITMS) seems to curb the menace of insider trading?

**(E)** How the financials of the company given in the exhibit 1 depicts about the unfair role of insider trading in the stock market and what course of action can be followed by such insiders on receiving such information? **(Max. 6 marks for coverage on each point)**

**Note:** Please use your name as ABC and your firm's name as XYZ Consulting.

#### (F) Multi Choice Questions (MCQs)

- (i) The following is not a systematic risk.
- a) Business Risk
  - b) Purchasing Power Risk

- c) Market Risk
  - d) Interest Rate Risk
- (ii) Which of the following is not the real risk of a security.
- a) Market Risk
  - b) Inflation Risk
  - c) Political Risk
  - d) Business Risk
- (iii) When a Collateralized Debt Obligation (CDO) does not acquire original assets but does a 'default swap', it is called \_\_\_\_\_
- a) Cash CDO
  - b) Market Value CDO
  - c) Swap CDO
  - d) Synthetic CDO
- (iv) Which of the following Fund focuses on trends that are likely to result in the 'out-performance' by certain sectoral funds.
- a) Contra Fund
  - b) Index Fund
  - c) Thematic Fund
  - d) Hedge Fund
- (v) Certificate of Deposit is a \_\_\_\_\_ negotiable instrument.
- a) Front-ended
  - b) Back-ended
  - c) Face Value
  - d) None of these
- (vi) Once client have identified a particular target company to be acquired advisory services are provided in which of the order.
- a) Short-Listing → Due Diligence → Preparing and Executing Term Sheet → Transaction Closure
  - b) Short-Listing → Preparing and Executing Term Sheet → Due Diligence → Transaction Closure
  - c) Due Diligence → Short-Listing → Preparing and Executing Term Sheet → Transaction Closure
  - d) Due Diligence → Preparing and Executing Term Sheet → Short-Listing → Transaction Closure
- (vii) The full form of SCSB is \_\_\_\_\_.
- a) Self-Credited Syndicate Bank
  - b) Self-Created Syndicate Bank
  - c) Self-Certified Syndicate Bank
  - d) None of These
- (viii) LME specializes in \_\_\_\_\_.
- a) Gold and Silver
  - b) Ferrous and Non Ferrous Metals

- c) Non Ferrous Metals  
d) All of These
- (ix) If the standard deviation of changes of spot and future prices of Copper are 4% and 6% respectively and hedge ratio is 0.60 then, correlation coefficient among these prices shall be\_\_\_\_\_.
- a) 0.25  
b) 0.60  
c) 0.75  
d) 0.90
- (x) In India \_\_\_\_\_ is also known as headline inflation rate.
- a) CII  
b) CPI  
c) WPI  
d) None of These

**(Each MCQ carries 2 Marks)**

**Exhibit 1**

**Today**

**DR WADES**  
Forecast a loss of more than ₹ 50 cr.

**CFDC BANK**  
The predicted profit of ₹ 3,900 cr and a GNPA of 1.25 per cent.

**SIXES BANK**  
GNPA 5.03; NNPA: 2.30; NIM: 3.63 against 3.63; Slippages: ₹ 8,000 cr (majority were from outside watch-list); Writeoff: ₹ 2,300 cr; CASA: 48.33 per cent.

**ABCD STEEL**  
Gross sales ₹ 33,900 cr; Ebitda 7,000 cr; Ebit 5,400 cr; Exceptional items ₹ 4,000 cr; PBT ₹ 257 cr; PAT loss of ₹ 7 cr.

**RAJENDRA HOLIDAYS**  
The message read “Rajendra holidays will declare a bonus today”.

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**Exhibit 2**

A recent news report identifies a dozen messages that accurately predicted Second Quarter (Q2) earnings patterns (and a bonus announcement in one case) for specific listed stocks. In each case, the messages were being passed around, just before the results were officially announced. These messages were being circulated in private Whatsapp groups frequented by equity traders. These were all big companies - in fact, more than half of the stocks concerned are members of the Nifty-50.

WhatsApp, an instant messaging service owned by Facebook, is a popular platform for all sorts of sensitive communications. It is encrypted end-to-end, making it impossible for even the service provider to monitor content.

It is not easy given the end-to-end encryption but it is possible for example, to set up specialised units to track and monitor such a medium. It is also possible for Sebi to set up an email id, for example, where such messages can be anonymously forwarded for analysis. That would give the regulator some idea about the scale of the problem and an opportunity to judge which messages are credible and actionable and worth following up.

India significantly toughened insider trading rules in early 2015, expanding what constitutes "unpublished price-sensitive information" to include "any information" that is not "generally available" and that could have a market impact.

The law also expanded the scope of who constitutes an "insider" to include "anyone in possession of or having access to unpublished price-sensitive information" regardless of how they came "in possession of or had access to such information".

Circulating "unpublished price-sensitive information" can result in penalties of up to 250 million rupees and a jail term of up to 10 years. The monetary amount can be higher if it can be proven that an individual traded on such information.

*(Source: Extract from a leading Newspaper)*

### **Exhibit 3**

#### **Consultation Paper by SEBI to curb unauthorized investment tips through social media**

Last year, SEBI issued a consultation paper on curbing unauthorized investment tips through social media. So, it proposed to ban unauthorised trading tips through SMSes, WhatsApp, Twitter, Facebook and other social media platforms, as also games, competitions and leagues relating to securities market. It also proposed an overhaul of regulations governing investment advisors.

Sebi also proposed to ban 'free trial' offers by investment advisors for their prospective clients and sought to make it mandatory for even registered research analysts to provide their research reports for all class of investors at the same time.

Sebi has also proposed a detailed 'advertisement code' for those providing investment advice to check misleading advertisements promising unrealistic returns in the securities market.

Sebi has also proposed a re-look on the exemption from registration as an investment adviser, provided to mutual fund distributors and other registered market intermediaries. Besides, banks, NBFCs and various corporate bodies would have to set up a separate subsidiary for investment advisory services. Under current rules, such services can be provided through a separate division or department.

Sebi has proposed a time period of three years for existing entities offering investment advisory services through separate department or division to set up a separate subsidiary. Similar time period can be provided to the mutual fund distributors and other registered market entities currently exempted from registration as investment advisors.

*(Source: Extract from a leading Newspaper)*

### **Exhibit 4**

#### **Need for Automation in insider trading**

Establishing a database of connected persons is a huge task to be done in excel. Top it up with the pre-clearance, monitoring of trading window for each trade for each connected person is an impossible task. Automation or Insider Trading Management System enables entities to comply with the regulations and stay on top.

Insider Trading Management System (ITMS) is an enterprise-class web application which can automate and address the challenge of complying with regulatory requirements specific to insider trading. It serves as a central repository of insider related information for reporting and analytics.

ITMS helps organizations easily capture details about "Insiders" and their relatives as per the policy definition. A workflow enabled pre-dealing approval as well as post trade update mechanism brings efficiency to request handling.

A configurable "Trading Window" and automated alerts & notifications add flexibility to the system.

### **ITMS Features**

Insider Information Collection is a process to build the user and relatives information or who may be terms as connected person. The tool provides for self-update of the profiles.

Trading window management includes configuration of blackout period and automated alerts and notification of opening and closing of trading window.

Built-in work flows for the process including pre-trading request/approval/rejections, and post trading disclosures.

Provides a work-flow for employees to submit pre-trading requests, compliance officer can view all the pre-trading approval requests in a central system, compare with restricted securities (grey list) and approve/reject the request.

Automatic reminders are generated from the system for initial and continual disclosures, post-trading updations.

*(Source:<http://www.riskpro.in/services/insider-trading-automation>)*

### **Exhibit 5**

#### **SOME OF THE PROVISIONS OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015**

*(d) "connected person" means,-*

(i) any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

(ii) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be connected persons unless the contrary is established, -

(a) an immediate relative of connected persons specified in clause (i); or

(b) a holding company or associate company or subsidiary company; or

(c) an intermediary as specified in section 12 of the Act or an employee or director thereof; or

(d) an investment company, trustee company, asset management company or an employee or director thereof; or

(e) an official of a stock exchange or of clearing house or corporation; or

(f) a member of board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or

(g) a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or

(h) an official or an employee of a self-regulatory organization recognised or authorized by the Board; or

(i) a banker of the company; or

(j) a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent. of the holding or interest;

(e) "generally available information" means information that is accessible to the public on a non-discriminatory basis;

(f) "immediate relative" means a spouse of a person, and includes parent, sibling, and child of such person or of the spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities;

(g) "insider" means any person who is:

- i) a connected person; or
- ii) in possession of or having access to unpublished price sensitive information;

(n) "unpublished price sensitive information" means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following: –

- (i) financial results;
- (ii) dividends;
- (iii) change in capital structure;
- (iv) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions;
- (v) changes in key managerial personnel; and
- (vi) material events in accordance with the listing agreement.

#### Exhibit 6

Actuals
<b>DR WADES</b> On a consolidated basis under Indian accounting standards, it posted a loss of ₹ 58 cr.
<b>CFDC BANK</b> The lender posted a profit after tax of ₹ 3,894 cr. Its GNPA was 1.24 per cent.
<b>SIXES BANK</b> GNPA is 5.03%; NNPA: 2.30 NIM: 3.63; Slippages: ₹ 3,519 cr; ₹ 2,300 cr; CASA: 48.33 per cent.
<b>ABCD STEEL</b> Gross sales ₹ 34,800 cr; Ebitda 6,982 cr; Ebit ₹ 5,393 cr; Exceptional items ₹ 4,069 cr; PBT ₹ 259 cr; PAT loss of ₹ 7.17 cr.
<b>RAJENDRA HOLIDAYS</b> 1 for 2 bonus share issue announced.