

MOCK TEST PAPER 1
FINAL (NEW) COURSE: GROUP – II
ELECTIVE PAPER 6B: FINANCIAL SERVICES AND CAPITAL MARKET PAPER

SUGGESTED SOLUTION

Note: Please note these solutions are for guidance purpose only.

Answers to Question No. 1

XYZ Consulting

Dated:

Mr. Zahir

Sub: Report on the various issues raised during our meeting dated.....

The point-wise reply on the various issues raised by you is as follows:

(A) Although in WhatsApp, it is not easy due to end-to-end encryption to monitor the messages but it is possible, 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 problem and an opportunity to judge which messages are credible and actionable and worth following up.

(B) As per SEBI Guidelines the meaning of the term 'insider' means any person who is:

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- (ii) in possession of or having access to unpublished price sensitive information;

and 'unpublished price sensitive information' is:

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.

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the law expanded the scope of who constitutes an "insider" to include "anyone in possession of or having access to unpublished price-sensitive information" regardless of how they came "in possession of or had access to such information".

Further circulating "unpublished price-sensitive information" can result in penalties of up to 250 million rupees and a jail term of up to 10 years.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.

- (C) Since Joseph was in possession of unpublished price sensitive information and he has circulated the data also, he can be called as 'insider'.
- (D) Insider Trading Management System (ITMS) 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.

- (E) Since the difference between the actual information compiled and the information as per the message is almost minuscule there is a clear cut case of insider trading. Further following course of action can be followed by such insiders on receiving such information.

Company	Course of action might have been followed by Insider
DR WADES	Since there is a prediction of loss. The insider will sell the shares he/ she own before the information is made public as price will fall after the announcement of results. (Insider can take short position in the shares)
CFDC BANK	Insider shall acquire the shares as bank is likely to post profit and very less GNPA. (Insider can take long position in the shares)
SIXES BANK	Since the results likely to be announced are not good e.g. rising GNPA etc. it is likely that the price of shares will fall. Hence insider shall sell his/ her shares. (Insider can take short position in the shares)
ABCD STEEL	Since there is likely announcement of losses, the share prices of the company shall fall. Accordingly, the insider shall sell the share before such announcement. (Insider can take short position in the shares)
RAJENDRA HOLIDAYS	Since after the announcement of bonus issue there is likely to be a rise in the prices of the shares, the insider shall purchase the shares. (Insider can take long position in the shares)

Thanks,

ABC

(Signature)

(F) Answers to Multi Choice Questions (MCQs)

- (i) (a)
- (ii) (d)
- (iii) (d)
- (iv) (c)
- (v) (a)
- (vi) (b)
- (vii) (c)
- (viii) (b)

(ix) (d)

(x) (c)

Answers to Question No. 2

Solution to (A)

Source	Name of the Scheme as per the exhibit	Proposed Recategorization		Reasons for such recategorization
Exhibit No.		Scheme	Category of Scheme	
2	Dream Venue Focused 25 Fund Regular Plan	Equity	Dream Focused Fund	It is a scheme focused (restrict) its holdings to not more than 30 companies. Furthermore, the fund has minimum investment in equity and equity related instruments upto 65%

Source	Name of the Scheme as per the exhibit	Proposed Recategorization		Reasons for such recategorization
Exhibit No.		Scheme	Category of Scheme	
3	Dream Venue Ultra Short Term Bond Fund - Regular Plan	Debt	Dream Ultra Short Duration Fund	It is an Open Ended Ultra-Short Scheme seeks to generate optimal returns consistent with moderate levels of risk and liquidity by investing in debt securities and money market securities such that the Macaulay Duration of the portfolio is between 6 – 12 months. However, in order to get itself Recategorized as per the SEBI circular, Macaulay Duration of the portfolio shall be between 3 – 6 months.

Source	Name of the Scheme as per the exhibit	Proposed Recategorisation		Reasons for such recategorisation
Exhibit No.		Scheme	Category of Scheme	
4	Dream Venue Dynamic Equity Fund - Regular Plan	Hybrid	Dynamic Asset Allocation or Balanced Advantage	As it is already given in the exhibit that the scheme seeks to generate long term capital appreciation by investing in equity and equity related instruments including equity derivatives as well as debt instruments. Further, the basic purpose of the scheme is to invest in equity/debt that is managed

				dynamically. In other words, it is an open ended dynamic asset allocation fund.
Source	Name of the Scheme as per the exhibit	Proposed Recategorisation		Reasons for such recategorisation
Exhibit No.		Scheme	Category of Scheme	
5	CFDH RSF	Solution Oriented Schemes	Retirement Fund	It is specifically given in the exhibit that it is a retirement funds. Further, it is mentioned that the main advantage of mutual funds' retirement products is that you don't have to buy an annuity, as is the case with the NPS or pension plans from insurance companies. Instead, you can opt for a systematic withdrawal plan to meet your regular cash flow needs. Since a part of the withdrawal is your principal, it will be more tax-efficient as well.

Source	Name of the Scheme as per the exhibit	Proposed Recategorisation		Reasons for such recategorisation
Exhibit No.		Scheme	Category of Scheme	
6	ITU Nifty Index Funds	Other Schemes	Index Funds/ETFs	The principal investment objective of this scheme is to invest in stocks of companies comprising S&P CNX Nifty Index and endeavour to achieve return equivalent to Nifty by passive investment. The scheme is managed by replicating the index in the same weightage as in the S&P CNX Nifty-Index with the intention of minimizing the performance differences between the scheme and the S&P CNX-Nifty Index in capital terms, subject to market liquidity, costs of trading, management expenses and other factors which may cause tracking error.

Solution to (B)

	Amount in Rs. lakhs	Amount in Rs. lakhs	Amount in Rs. lakhs
Opening Bank (150-140-8)	2.00		
Add: Proceeds from sale of securities	48.00		
Add: Dividend received	<u>2.00</u>	<u>52.00</u>	
Deduct: Cost of securities purchased	42.40		
Fund management expenses paid (6.0 - 0.5)	5.50		
Capital gains distributed = 80% of (48.00 - 45.75)	1.80		
Dividend distributed = 80% of 2	<u>1.60</u>	<u>51.30</u>	
Closing Bank			0.70
Closing market value of portfolio			<u>148.75</u>
			149.45
Less: Arrears of expenses			<u>0.50</u>
Closing Net Assets			148.95
Number of units (Lakhs)			15.00
Closing NAV per unit			9.93

Rate of Earning

	Amount
Income received (1.8+1.6)/15	0.23
Loss: Loss on disposal (10 - 9.93)	0.07
Net earning	0.16
Initial investment	10.00
Rate of earning (monthly)	1.6%
Rate of earning (Annual)	19.2%

Note: Alternatively, Rate of earning can also be computed on the basis of 1000 units. However, the final answer shall remain the same.

Solution to (C)**Answers to Multiple Choice Questions**

- (i) (b)
- (ii) (a)
- (iii) (d)
- (iv) (d)
- (v) (a)
- (vi) (a)
- (vii) (c)
- (viii) (a)
- (ix) (d)
- (x) (b)

Answers to Question No. 3

- (i) After the bonus announcement, the investors have not reacted positively. The reasons for this may be because the company has piled up excess cash and it has not enough investment opportunities.
- (ii) After the bonus issue, EPS will reduce. The reason is that after the bonus issue, the number of shares will increase leading to increase in denominator while numerator i.e. Profit after tax is same. This leads to fall in the value of EPS.

- (iii) (a) As per regulation 95 of Schedule IX of SEBI (ICDR) Regulation, 2009, if an issuer after the approval of its board of directors which does not require the shareholders' approval for bonus issue shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors.

However, where the issuer is required to seek shareholders' approval for bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

- (b) While calculating basic earnings per share, profit after tax after preference dividend is divided by the total number of equity shares outstanding. On the other hand, in the computation of diluted earnings per share, debt which can be converted into equity in the future is also taken into account. Since, ABC Ltd. is a debt free company; there is no convertible debt on its part. Therefore, basis earning per share and diluted earnings per share are equal.

Further, it is provided in the SEBI Guidelines on Bonus Issue that no company shall make a bonus issue of equity shares unless it has made reservation for holders of convertible debt instruments.

However, since ABC Ltd. is a debt free company, the above provision is not applicable to it.

- (c) It is clearly provided in the SEBI regulations that once the decision to make a bonus issue is announced, the issue cannot be withdrawn.
- (iv) It is generally considered prudent to pay dividend consistently even after the bonus issue. Higher dividend payout on the part of ABC Ltd. indicates that existing shareholders will get more dividend after the bonus issue.

For example, in the given case, the company issues bonus shares in the ratio of 1: 1. It declared dividend of 10% which will be Rs. 1 on the face value of Rs. 10 in the previous year. In the current year, it decides to maintain the dividend at 10%. Now, a shareholder with one share will get an additional share. His total shares will be 2. And, he is eligible for total dividend of Rs. 2 (Rs. 1 x 2 shares). So, his dividend income will be doubled due to issue of bonus shares.

Therefore, higher dividend payout on the part of ABC Ltd indicates willingness on the part of company to keep the shareholders happy and increase their wealth. Also, the company can utilize it's excess cash reserves in this way.

- (v) The Market Price (MP) just before and after the ex-bonus date on both the stock exchanges and calculation of Price Earnings Ratio (P/E) ratio is as follows:

Ex-bonus date – 15/6/2015

P/E Ratio = Market Price Per Share/Earning Per Share

If the EPS of 31st March, 2015 has been taken

ESB

(MP) just before the ex-bonus date i.e. on 12/6/2015 – 1976.65

P/E Ratio = $1976.65/52.96 = 37.32$

(MP) just after the ex-bonus date i.e. on 16/6/2015 – 999.45

P/E Ratio = $999.45/52.96 = 18.87$

ESN

(MP) just before the ex-bonus date i.e. on 12/6/2015 – 1975.05

P/E Ratio = $1975.05/52.96 = 37.29$

(MP) just after the ex-bonus date i.e. on 16/6/2015 – 999.35

P/E Ratio = $999.35/52.96 = 18.87$

If the EPS of 31st March, 2016 has been taken

ESB

(MP) just before the ex-bonus date i.e. on 12/6/2015 – 1976.65

P/E Ratio = $1976.65/68.73 = 28.75$

(MP) just after the ex-bonus date i.e. on 16/6/2015 – 999.45

P/E Ratio = $999.45/68.73 = 14.54$

ESN

(MP) just before the ex-bonus date i.e. on 12/6/2015 – 1975.05

P/E Ratio = $1975.05/68.73 = 28.73$

(MP) just after the ex-bonus date i.e. on 16/6/2015 – 999.35

P/E Ratio = $999.35/68.73 = 14.54$

(vi) The company is debt free as it can be observed from the Balance Sheet of the company. The reason for such non debt element in the capital structure of the company may be due to the fact company has large cash reserves which can be utilized for short term working capital requirements of the company. Further, the exclusion of debt in the capital structure reduces the periodic interest cost on the part of the company. Also, there is the possibility of default risk which may arise due to non-payment of interest and principal amount of loan.

(vii) As it has been given in the case study itself sufficient cash balance has been kept by the company to meet its strategic objectives. The company presently generates sufficient cash internally to finance all its operational, financing and investment requirements.

The impact of high cash holding is that the cash is underutilized and the company is losing investment opportunities. So, ABC Ltd. may consider a buyback to utilize its cash pile.

Answers to Multiple Choice Questions

(i) (d)

(ii) (a)

(iii) (a)

(iv) (c)

(v) (b)

(vi) (d)

(vii) (a)

(viii) (a)

(ix) (d)

(x) (a)