MEANING OF FINANCIAL SERVICES

financial services
Definition
Services and products provided to consumers and businesses by financial institutions such as banks, insurance companies, brokerage firms, consumer finance companies, and investment companies all of which comprise the financial services industry.

TYPES OF FINANCIAL SERVICES

Financial services are basically deal with merchant banks, credit card companies, consumer finance companies, stock brokerages or with the management of money. In the term of earning, financial services are the largest industry in the world that represents 20 percent of the market capitalization.

Gramm-Leach-Blilry Act enabled different types of companies in the US financial services industry to merge. Now a days, in US every company describes themselves as a financial services institution such as, Bank of America offers full-features brokerage products, while E*trade has expanded into offering bank accounts and loans.

Two types of approaches:

Two different types of appraoches which companies usually prefer. In the first approach, bank buys an insurance company or an investment bank, adds the acquisition to its holding company to diversify its earnings and also keeps the original brands of the aquired firm. This type is essential for the Citigroup as well as JP Morgan Chase.

On the other hand, a bank attempts to sell the products to its existing customers, with incentives for combining all things with one company by creating its own brokerage division or insurance division.

Some essential primary banking services:

When ever needed allow withdrawls and keeps money safe.

It provides the provision of loans and moratgage loans that are needed to purchase a home, and property as well as business.

The use of Automatic teller Machines (ATM) allows financial transactions at branches.

To meet monthly spending commitments of customers in their current account, provide overdraft agreements for the temporary advancement of the Bank's own money.

To settle credit advances monthly, provide Charge cards advances of the Bank's own Monet for customers wishing.

For making bills and payments automatically, they provide the facility of standing orders and direct debits.

Custody Services

For the financial services, custody services and securities processing, is a kind of 'bank-office administration'.

Some firms engaged in custody services are

State Street Corporation: It provides products and services for portfolios of investment assets and also focuses on its services on institutional investors and investment management.

The bank of New York: It was a global financial services company and now it continues with the new name 'The bank of new york Mellon Corporation'. It operated four primary business areas such as:

- Securities services
- Private banking
- Investment management
- Treasury management

Intermediation or advisory services

Companies with a branch presence are known as Private client services or full services brokerages whereas stock broker's assits people in investing, online companies called discount brokerages.

Coglomerates

It is a financial services firm that can be active in more than one sector at a time of a financial service market such as asset management, retail banking, general health insurance etc.

Market share

In the term of equity market cap and earnings, the financial services industry constitutes the largest group of companies in the world.

Custody services

Custody services and security services are basically used for financial services which are called a kind of 'back-office administration'. The amount of assets under custody was estimated around $65 trillion at the end of 2004 in world.

Some firms that are involved in custody services are

- JPMorgan Chase
- Mellon Financial Corporation
- Investors Bank and Trust

Commercial bank

When a term bank is quoted it generally refers to as a commercial bank. The other type of banking sectoe generally is known as Investment banking. An investment bank in its basic nature like other form of bank does not lend money to individual or business group.instead it raises money by getting the money invested in the form of stocks or bonds.varied banks exists across the globe.

Some major banks are

- Bank of America
- Citigroup
- HSBC
- JP Morgan Chase
- Credit Agricole Group

Private banking

Private banking is another term for a financial service company that targets at providing large margin loans to reputed individuals or business houses

major private banking names are

- JPMorgan private bank
- Goldman Sachs
- UBS
- Citigroup Private Bank
- HSBC private Bank

PLAYERS IN FINANCIAL SERVICES

Key Agencies which operate in financial services market

- Investors
- Company /Issuer
- Exchange
- Investment Manager

- Broker/ Dealers
- Custodian
- Clearing Corporation
- Depository
- Depository Participant

Investor

An individual or a company which buys and sells securities with an investment objective is known as investor. An individual investor could be a retail client, and institutional investors could be an Investment Manager, Mutual Fund, Bank or Company that invest in securities either on behalf of their clients or on their own account e.g. UTI (mutual fund), Axa Investment Managers (Investment Manager).

Company/ Issuer

The corporate entity that issues securities, which are traded on the stock exchange e.g. Reliance Industries Ltd.., Proctor & Gamble, IBM. It is always possible that one company may have its securities listed on many exchanges.

Exchanges

•A platform for the buyer and the seller to trade in the securities e.g.

New York Stock Exchange formed in 1792

London Stock Exchange, NASDAQ,

Chicago Mercantile Exchange, Chicago Board Of Trade

In India - NSE, BSE

•Performs various roles such as:

• Admission of securities for trading - listing

• Admission of members who can trade in the securities

• Defining market segments like Equity / Debt / Derivative Market segment

• Defining market indices like Sensex, Dow Jones, Nifty

• Defining price range for trading

• Monitoring the trading activities - surveillance on day to day basis.

• Regulating the activities of the members of the exchange.

Investment Manager

The agency which acts on behalf of its clients, and buys or sells securities through brokers, on various stock exchanges e.g. Alliance Capital Management. Also provides value added services like portfolio management to its clients.

Operate in various instruments and market regions spreading across the world. May have an identified set of brokers and custodians through which it deals.

Brokers / Dealers

A member of a given stock exchange authorized to trade only on that exchange. He/she can be a member of multiple exchanges at a time.

Allowed to trade in securities on multiple exchanges at the same time and can be an individual or a corporate entity like Merrill Lynch, MSDW.

Only members can trade on the exchange - investors cannot trade directly If a member gives both buy and sell quotes for a given security, he is called a market maker in that security. If he deals on his own account, he is called dealers Has final obligation to honor the trades done by him on the exchange

Custodian

The agency which keeps custody of physical and electronic holdings on behalf of their clients (investors).e.g. HSBC, ABN AMRO Bank

They also provide additional services like cash management, accounting, taxation, reporting and effecting corporate actions on the clients' holdings. They also execute settlement instructions received from the client or client's broker or investment manager

They may operate across different countries and act as Global Custodians. As global custodians, they act through central security depositories, international central security depositories and local agents.

As Local Custodian or Local Agent they represent the global custodians in the domestic market

Clearing Corporation

The agency which keeps track of buy and sell trades done by the members e.g. National Securities Clearing Corporation (NSCCL).

It calculates the obligations for the member, for a given trading period. May also impose and collect margins on behalf of the exchange on outstanding positions of the members. It ensures the settlement of the trades done on the stock exchange and act as a clearing and settlement body for one or more stock exchanges like NSCCL in USA. It may also act as Central Counterparties in case obligations are netted.

Depository

The agency which provides services like holding of electronic shareholding against immobilization / dematerialization of securities, re-materialization of securities, lending and pledging of electronic shares e.g. National Securities Depository Ltd (NSDL), SIS Sega Intersettle - Central Security Depositories are Registered owners.

Depository Participant

The intermediary registered with a depository, which acts as a channel for investors for opening accounts, maintaining electronic holdings and carrying out transactions with the depository e.g. Credit Lyonnais, HDFC Bank.It keeps the electronic holdings on behalf of the investor. An investor may keep holdings with one or more DPs. It offers services like dematerialization, re-materialization, execution of client instructions for debit / credit of securities from their accounts

MERCHANT BANKING

Merchant Banking Meaning - Functions of Merchant Banking

Merchant Banking Meaning

Merchant Banking is a combination of Banking and consultancy services. It provides consultancy, to its clients, for financial, marketing, managerial and legal matters. Consultancy means to provide advice, guidance and service for a fee. It helps a businessman to start a business. It helps to raise (collect)finance. It helps to expand and modernise the business. It helps in restructuring of a business. It helps to revive sick business units. It also helps companies to register, buy and sell shares at the stock exchange.

In short, merchant banking provides a wide range of services for starting until running a business. It acts as Financial Engineer for a business.

Merchant banking was first started in India in 1967 by Grindlays Bank. It has made rapid progress since 1970.

Functions of Merchant Banking

The important functions of merchant banking are depicted below.

The functions of merchant banking are listed as follows:

1. **Raising Finance for Clients :** Merchant Banking helps its clients to raise finance through issue of shares, debentures, bank loans, etc. It helps its clients to raise finance from the domestic and international market. This finance is used for starting a new business or project or for modernization or expansion of the business.
2. **Broker in Stock Exchange** : Merchant bankers act as brokers in the stock exchange. They buy and sell shares on behalf of their clients. They conduct research on equity shares. They also advise their clients about which shares to buy, when to buy, how much to buy and when to sell. Large brokers, Mutual Funds, Venture capital companies and Investment Banks offer merchant banking services.
3. **Project Management :** Merchant bankers help their clients in the many ways. For e.g. Advising about location of a project, preparing a project report, conducting feasibility studies, making a plan for financing the project, finding out sources of finance, advising about concessions and incentives from the government.
4. **Advice on Expansion and Modernization :** Merchant bankers give advice for expansion and modernization of the business units. They give expert advice on mergers and amalgamations, acquisition and takeovers, diversification of business, foreign collaborations and joint-ventures, technology upgradation, etc.
5. **Managing Public Issue of Companies :** Merchant bank advice and manage the public issue of companies. They provide following services:
    i. Advise on the timing of the public issue.
    ii. Advise on the size and price of the issue.
    iii. Acting as manager to the issue, and helping in accepting applications and allotment of securities.
    iv. Help in appointing underwriters and brokers to the issue.
    v. Listing of shares on the stock exchange, etc.

6. **Handling Government Consent for Industrial Projects :** A businessman has to get government permission for starting of the project. Similarly, a company requires permission for expansion or modernization activities. For this, many formalities have to be completed. Merchant banks do all this work for their clients.

7. **Special Assitance to Small Companies and Entreprenuers :** Merchant banks advise small companies about business opportunities, government policies, incentives and concessions available. It also helps them to take advantage of these opportunities, concessions, etc.

8. **Services to Public Sector Units :** Merchant banks offer many services to public sector units and public utilities. They help in raising long-term capital, marketing of securities, foreign collaborations and arranging long-term finance from term lending institutions.

9. **Revival of Sick Industrial Units :** Merchant banks help to revive (cure) sick industrial units. It negotiates with different agencies like banks, term lending institutions, and BIFR (Board for Industrial and Financial Reconstruction). It also plans and executes the full revival package.

10. **Portfolio Management :** A merchant bank manages the portfolios (investments) of its clients. This makes investments safe, liquid and profitable for the client. It offers expert guidance to its clients for taking investment decisions.

11. **Corporate Restructuring :** It includes mergers or acquisitions of existing business units, sale of existing unit or disinvestment. This requires proper negotiations, preparation of documents and completion of legal formalities. Merchant bankers offer all these services to their clients.

12. **Money Market Operation** : Merchant bankers deal with and underwrite short-term money market instruments, such as:

    i. Government Bonds.

    ii. Certificate of deposit issued by banks and financila institutions.

    iii. Commercial paper issued by large corporate firms.

iv. Treasury bills issued by the Government (Here in India by RBI).

13. **Leasing Services :** Merchant bankers also help in leasing services. Lease is a contract between the lessor and lessee, whereby the lessor allows the use of his specific asset such as equipment by the lessee for a certain period. The lessor charges a fee called rentals.

14. **Management of Interest and Dividend :** Merchant bankers help their clients in the management of interest on debentures / loans, and dividend on shares. They also advise their client about the timing (interim / yearly) and rate of dividend.

MANAGING OF NEW ISSUES IN MERCHANT BANKING

Introduction

The new issue market / activity was regulated by the Controller of Capital Issues (CCI) under the provisions of the Capital Issues (Control) Act, 1947 and the exemption orders and rules made under it. With the repeal of the Act and the consequent abolition of the office of the CCI in 1992, the protection of the interest of the investors in securities market and promotion of the development and regulation of the market/ activity became the responsibility of the SEBI. To tone up the operations of the new issues in the country, it has put in place rigorous measures. These cover both the major intermediaries as well as the activities.

So, we will discuss here, various intermediaries, their regulation and SEBI guidelines related to them.

Merchant Bankers

In modern times, importance of merchant banker is very much, because it the key intermediary between the company and issue of capital. Main activities of the merchant bankers are – determining the composition of the capital structure, drafting of prospectus and application forms, compliance with procedural formalities, appointment of registrars to deal with the share application and transfer, listing of securities, arrangement of underwriting / sub-underwriting, placing of issues, selection of brokers, bankers to the issue, publicity and advertising agents, printers and so on.

Due to overwhelming importance of merchant banker, it is now mandatory that merchant banker(s) functioning as lead manager(s) should manage all public issues. In case of rights issue not exceeding Rs.50 lakh, such appointments may not be necessary. The salient features of the SEBI framework, related to merchant bankers are discussed as under.

Registration : Merchant bankers require compulsory registration with the SEBI to carry out their activities. Previously there were four categories of merchant bankers, depending upon the activities. Now, since Dec. 1997, there is only one category of registered merchant banker and they perform all activities.

Grant of Certificate : The SEBI grants a certificate of registration to applicant if it fulfills all the conditions like (i) it is a body corporate and is not a NBFC (ii) it has got necessary infrastructure to support the business activity (iii) it has appointed at least

two qualified and experienced (in merchant banking) persons
(iv) its registration is in the general interest of investors.
Capital Adequacy Requirement : A merchant banker must have adequate capital to support its business. Hence SEBI grants recognition to only those merchant bankers who have paid up capital and free reserves of minimum Rs. 1 crore.
Fee: A merchant banker has to pay a registration fee of Rs. 5 lakh and renewal fees of Rs. 2.5 lakh every three years from the fourth year from the date of registration.
Code of Conduct : Every merchant banker has to abide by the code of conduct, so as to maintain highest standards of integrity and fairness, quality of services, due diligence and professional judgment in all his dealings with the clients and other people. A merchant banker has always to endeavor to (a) render the best possible advice to the clients regarding clients needs and requirements, and his own professional skill and (b) ensure that all professional dealings are effected in a prompt, efficient and cost effective manner.
Restriction on Business : No merchant banker, other than a bank/public financial institution is permitted to carry on business other than that in the securities market w.e.f. Dec.1997. However a merchant banker who is registered with RBI as a primary dealer/satellite dealer may carry on such business as may

be permitted by RBI w.e.f. Nov.1999.

Maximum number of lead managers : The maximum number of lead managers is related to the size of the issue. For an issue of size less than Rs. 50 crores, two lead managers are appointed. For size groups of 50 to 100 crores and 100 to 200 crores, the maximum permissible lead managers are three and four respectively. A company can appoint five and five or more (as approved by SEBI) lead managers in case of issue sizes between Rs.200 to 400 crores and above Rs.400 crores respectively.

Responsibilities of Lead Managers : Every lead manager has to enter into an agreement with the issuing companies setting out their mutual rights, liabilities and obligation relating to such issues and in particular to disclosure, allotment and refund. A statement specifying these is to be furnished to the SEBI at least one month before the opening of the issue for subscription. It is necessary for a lead manager to accept a minimum underwriting obligation of 5% of the total underwriting commitment or Rs. 25 lakh whichever is less.

Due diligence certificate : The lead manager is responsible for the verification of the contents of a prospectus / letter of offer in respect of an issue and the reasonableness of the views expressed in them. He has to submit to the SEBI at least two weeks before the opening of the issue for subscription a due diligence certificate.

Submission of documents : The lead managers to an issue have to submit at least two weeks before the date of filing with the ROC/regional SE or both, particulars of the issue, draft prospectus/ letter of offer, other literature to be circulated to the investors / shareholders, and so on to the SEBI. They have to ensure that the modifications/ suggestions made by it with respect to the information to be given to the investors are duly incorporated.

Acquisition of Shares : A merchant banker is prohibited from acquiring securities of any company on the basis of unpublished price sensitive information obtained during the course of any professional assignment either from the client or otherwise.

Disclosure to SEBI : As and when required, a merchant banker has to disclose to SEBI (i) his responsibilities with regard to the management of the issue, (ii) any change in the information/ particulars previously furnished which have a bearing on the certificate of registration granted to it, (iii) names of the companies whose issues he has managed or has been associated with (iv) the particulars relating to the breach of capital adequacy requirements and (v) information relating to his activities as manager, underwriter, consultant or advisor to an issue.

Action in case of Default : A merchant banker who fails to comply with any conditions subject to which the certificate of registration has been granted by SEBI and / or contravenes any of the provisions of the SEBI Act, rules or regulations, is liable to any of the two penalties (a) Suspension of registration or (b) Cancellation of registration.

Underwriters

Another important intermediary in the new issue/ primary market is the underwriters to issue of capital who agree to take up securities which are not fully subscribed. They make a commitment to get the issue subscribed either by others or by themselves. Though underwriting is not mandatory after April 1995, its organization is an important element of primary market. Underwriters are appointed by the issuing companies in consultation with the lead managers / merchant bankers to the issues.

Registration : To act as underwriter, a certificate of registration must be obtained from SEBI. On application registration is granted to eligible body corporate with adequate infrastructure to support the business and with net worth not less than Rs. 20 lakhs.

Fee : Underwriters had to pay Rs. 5 lakh as registration fee and Rs. 2 lakh as renewal fee every three years from the fourth year from the date of initial registration. Failure to pay renewal fee leads to cancellation of certificate of registration.

General Obligations and responsibilities

Code of conduct : Every underwriter has at all times to abide by the code of conduct; he has to maintain a high standard of integrity, dignity and fairness in all his dealings. He must not make any written or oral statement to misrepresent (a) the services that he is capable of performing for the issuer or has rendered to other issues or (b) his underwriting commitment.

Agreement with clients : Every underwriter has to enter into an agreement with the issuing company. The agreement, among others, provides for the period during which the agreement is in force, the amount of underwriting obligations, the period within which the underwriter has to subscribe to the issue after being intimated by/on behalf of the issuer, the amount of commission/brokerage, and details of arrangements, if any, made by the underwriter for fulfilling the underwriting obligations.

General responsibilities : An underwriter cannot derive any direct or indirect benefit from underwriting the issue other than by the underwriting commission. The maximum obligation under all underwriting agreements of an underwriter cannot exceed twenty times his net worth. Underwriters have to subscribe for securities under the agreement within 45 days of the receipt of intimation from the issuers.

Bankers to an Issue

The bankers to an issue are engaged in activities such as acceptance of applications along with application money from the investor in respect of capital and refund of application money.

Registration : To carry on activity as a banker to issue, a person must obtain a certificate of registration from the SEBI. The applicant should be a scheduled bank. Every banker to an issue had to pay to the SEBI an annual free for Rs. 5 lakh and renewal fee or Rs. 2.5 lakh every three years from the fourth year from the date of initial registration. Non-payment of the prescribed fee may lead to the suspension of the registration certificate.

General Obligations and Responsibilities

Furnish Information : When required, a banker to an issue has to furnish to the SEBI the following information : (a) the number of issues for which he was engaged as banker to an issue (b) the number of applications / details of the applications money received (c) the dates on which applications from investors were forwarded to the issuing company / registrar to an issue (d) the dates / amount of refund to the investors.

Books of account/record / documents : A banker to an issue is required maintain books of accounts/ records/ documents for a minimum period of three years in respect of, inter alia, the number of applications received, the names of the investors, the time within which the applications received were forwarded to the issuing company / registrar to the issue and dates and amounts of refund money to investors.

Agreement with issuing companies : Every banker to an issue enters into an agreement with the issuing company. The agreement provides for the number of collection centers at which application/ application money received is forwarded to the registrar for issuance and submission of daily statement by the designated controlling branch of the baker stating the number of applications and the amount of money received from the investor.

Code of Conduct : Every banker to an issue has to abide by a code of conduct. He should observe high standards of integrity and fairness in all his dealings with clients/ investors/ other members of the profession. He should exercise due diligence. A banker to an issue should always endeavor to render the best possible advice to his clients and ensure that all professional dealings are effected in a prompt, efficient and cost-effective manner.

Brokers to the Issue

Brokers are persons mainly concerned with the procurement of subscription to the issue from the prospective investors. The appointment of brokers is not compulsory and the companies are free to appoint any number of brokers. The managers to the issue and the official brokers organize the preliminary distribution of securities and procure direct subscription from as large or as wide a circle of investors as possible. A copy of the consent letter from all the brokers to the issue, should be filed with the prospectus to the ROC.

The brokerage applicable to all types of public issue of industrial securities is fixed at 1.5%, whether the issue is underwritten or not. The listed companies are allowed to pay a brokerage on private placement of capital at a maximum rate of 0.5%. Brokerage is not allowed in respect of promoters' quota including the amounts taken up by the directors, their friends and employees, and in respect of the rights issues taken by or renounced by the existing shareholders. Brokerage is not payable when the applications are made by the institutions/ bankers against their underwriting commitments or on the amounts devolving on them as underwriters consequent to the under subscription of the issues.

Registrars to an Issue and Share Transfer

Agents

The registrars to an issue, as an intermediary in the primary market, carry on activities such as collecting applications from the investors, keeping a proper record of applications and money received from the investors or paid to the sellers of securities and assisting companies in determining the basis of allotment of securities in consultation with the stock exchanges, finalizing the allotment of securities and processing / dispatching allotment letters, refund orders, certificates and other related documents in respect of the issue of capital.

To carry on their business, the registrars must be registered with the SEBI. They are divided into two categories : (a) Category I, to carry on the activities as registrar to an issue and share transfer agent; (b) Category II, to carry on the activity either as registrar or as a share transfer agent. Category I registrars mush have minimum net worth of Rs. 6 lakhs and Category II, Rs. 3. Category I is required to pay a initial registration fee of Rs. 50,000 and renewal fee of Rs.40,000 every three years, where as Category II is required to pay Rs.30,000 and Rs. 25,000 respectively.

Code of Conduct : The registrars to an issue and the share transfer agents have to maintain high standards of integrity and fairness in all dealings with their clients and other registrars to the issue and share transfer agents in the conduct of the business. They should endeavor to ensure that (a) enquiries from investors are adequately dealt with, and (b) adequate steps are taken for proper allotment of securities and refund of application money without delay and as per law. Also, they should not generally and particularly in respect of any dealings in securities to be a party to (a) creation of false market, (b) price rigging or manipulation (c) passing of unpublished price sensitive information to brokers, members of stock exchanges and other intermediaries in the securities market or take any other action which is not in the interest of the investors and (d) no registrar to an issue, share transfer agent or any of its directors, partners or managers managing all the affairs of the business is either on their respective accounts, or though their respective accounts, or through their associates or family members, relatives or friends indulges in any insider trading.

Debenture Trustees

A debenture trustee is a trustee for a trust deed needed for securing any issue of debentures by a company. To act as a debenture trustee a certificate from the SEBI is necessary. Only scheduled commercial banks, PFIs, Insurance companies and companies are entitled to act as a debenture trustees. The certificate of registration is granted to suitable applicants with adequate infrastructure, qualified manpower and requisite funds. Registration fee is Rs. 5 lakh and renewal fee is Rs. 2.5 lakh every three years.

Responsibilities and obligations : Before the issue of debentures for subscription, the consent in writing to the issuing company to act as a debenture trustee is obligatory. He has to accept the trust deed which contains matters pertaining to the different aspects of the debenture issue.

Duties : The main duties of a debenture trustee include the following :

i. Call for periodical report from the company.

ii. Inspection of books of accounts, records, registration of the company and the trust property to the extent necessary for discharging claims.

iii. Take possession of trust property, in accordance with the provisions of the trust deed.

iv. Enforce security in the interest of the debenture holders.

v. Carry out all the necessary acts for the protection of the debenture holders and to the needful to resolve their grievances.

vi. Ensure refund of money in accordance with the Companies Act and the stock exchange listing agreement.

vii. Exercise due diligence to ascertain the availability of the assets of the company by way of security as well as their adequacy / sufficiency to discharge claims when they become due.

viii. Take appropriate measure to protect the interest of the debenture holders as soon as any breach of trust deed/ law comes to notice.

ix. Ascertain the conversion / redemption of debentures in accordance with the provisions / conditions under which they were offered to the holders.

x. Inform the SEBI immediately of any breach of trust deed / provisions of law.

In addition, it is also the duty of trustees to call or ask the company to call a meeting of the debenture holders on a requisition in writing signed by debenture holders, holding at least one-tenth of the outstanding amount, or on the happening of an event which amounts to a default or which, in his opinion, affects their interest.

Portfolio Managers

Portfolio manager are defined as persons who in pursuance of a contract with clients, advise, direct, undertake on their behalf the management/ administration of portfolio of securities/ funds of clients. The term portfolio means the total holdings of securities belonging to any person. The portfolio management can be (i) Discretionary or (ii) Non-discretionary. The first type of portfolio management permits the exercise of discretion in regard to investment / management of the portfolio of the securities / funds. In order to carry on portfolio services, a certificate of registration from SEBI is mandatory.

The certificate of registration for portfolio management services is granted to eligible applicants on payment of Rs.5 lakh as registration fee. Renewal may be granted by SEBI on payment of Rs. 2.5 lakh as renewal fee (every three years).

Contract with clients : Every portfolio manager is required, before taking up an assignment of management of portfolio on behalf of the a client, is enter into an agreement with such clients clearly defining the inter se relationship, and setting out their mutual rights, liabilities and obligations relating to the management of the portfolio of the client. The contract should, inter alia, contains :

i. The investment objectives and the services to be provided.

ii. Areas of investment and restrictions, if any, imposed by the client with regards to investment in a particular company or industry.

iii. Attendant risks involved in the management of portfolio.

iv. Period of the contract and provisions of early termination, if any.

v. Amount to be invested.

vi. Procedure of setting the clients' account including the form of repayment on maturity or early termination of contract.

vii. Fee payable to the portfolio managers

viii.Custody of securities.

The funds of all clients must be placed by the portfolio manager in a separate account to be maintained by him in a scheduled commercial bank. He can charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and such fee should be independent of the returns to the client and should not be on a return sharing basis.

Investment of Clients money : The portfolio manager should not accept money or securities from his clients for less than one year. Any renewal of portfolio fund on the maturity of the initial period is deemed as a fresh placement for a minimum period of one year. The portfolio funds and be withdrawn or taken back by the portfolio clients at his risk before the maturity date of the contract under the following circumstances :

a. Voluntary or compulsory termination of portfolio management services by the portfolio manager.

b. Suspension or termination of registration of portfolio manager by the SEBI.

c. Bankruptcy or liquidation in case the portfolio manager is a body corporate.

d. Permanent disability, lunacy or insolvency in case the portfolio manager is an individual.

The portfolio manager can invest funds of his clients in money market instruments or as specified in the contract, but not in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies. While dealing with client's money he should not indulge in speculative transactions.

Reports to be furnished to the Clients : The portfolio manager should furnish periodically a report to the client, agreed in the contract, but not exceeding a period of six months containing the following details :

a. The composition and the value of the portfolio, description of security, number of securities, value of each security held in portfolio, cash balances aggregate value of the portfolio as on the date of report.

b. Transactions undertaken during the period of report including the date of transaction and details of purchases and sales.

c. Beneficial interest received during that period in respect of interest, dividend, bonus shares, rights shares and debentures,

d. Expenses incurred in managing the portfolio of the client and details of risk relating to the securities recommended by the portfolio manager for investment or disinvestments.

So, we discussed so far the intermediaries in security market. Next task of yours would be to submit in writing the latest regulations of SEBI in the regards to various intermediaries.

VENTURE CAPITAL

Definition of 'Venture Capital'

Money provided by investors to startup firms and small businesses with perceived long-term growth potential. This is a very important source of funding for startups that do not have access to capital markets. It typically entails high risk for the investor, but it has the potential for above-average returns.

NEED OF VENTURE CAPITAL

Need of venture capital

- There are entrepreneurs and many other people who come up with bright ideas but lack the capital for the investment. What these venture capitals do are to facilitate and enable the start up phase.
- When there is an owner relation between the venture capital providers and receivers, their mutual interest for returns will increase the firms motivation to increase profits.
- Venture capitalists have invested in similar firms and projects before and, therefore, have more knowledge and experience. This knowledge and experience are the outcomes of the experiments through the successes and failures from previous ventures, so they know what works and what does not, and how it works. Therefore, through venture capital involvement, a portfolio firm can initiate growth, identify problems, and find recipes to overcome them.

FUNCTIONS OF VENTURE CAPITAL

1. The functions of venture capitalists and growth stages of their portfolio firms

1.1. **Classic venture capitalists and merchant venture capitalists**

Bygrave and Timmons discuss the functions of venture capitalists around the growth stage of portfolio firms. Venture capitalists that actively involve themselves during the early stages of ventures are known as classic venture capitalists. The origins of classic venture capitalism began in 1946 in the U.S., with American Research and Development, the first organized venture capital firm. After the 1980s in the U.S., as the venture capital industry grew in magnitude, there was also an increase of merchant venture capitalists that fulfilled only the role of providers of capital without investment methods where the lead investor actively supported the portfolio firms. Bygrave and Timmons continue to discuss the differences between classic venture capitalists and merchant venture capitalists with regard to investment targets, strategies and post-investment activities. For investment strategies, classic venture capitalists invest in startups and early stage ventures with high market potential and focus on being lead investors, while merchant venture capitalists target relatively cheap publicly-listed companies and management buyouts without much thought for market potential, and remain as co-investors. With regards to post-investment activities, classic venture capitalists focus on increasing value, while merchant venture capitalists rely on financial engineering for quick entry and exits, and exploit hot IPO markets to harvest early and often (Bygrave and Timmons, 1992).

1.2. Diversified investment or specialized investment -pre-investment activities-

According to portfolio theory, factors that affect fluctuations in return on investments can the unique factors of individual firms and factors that are shared by all firms. The former refers to

unique risk, while the latter refers to market risk. When as many portfolios as possible are mixed

during a risk diversification, it is possible to reduce a large portion of unique risk while leaving market

risk (Brearley and Myers, 2000). The co-investor investment strategy taken by merchant venture

capitalists is a diversified investment strategy based on portfolio theory. This diversified investment

strategy can be described as “Trade the horse before the horse dies” (Bygrave and Timmons, 1992),

with investments diversified by several criteria, and a quick withdrawal from portfolios that do not

appear to be able to produce the expected results.

On the other hand, the lead investor investment strategy adopted by classic venture capitalists is

known as specialized investment strategy. In portfolio theory, if all other conditions are similar, the

risk of portfolio firms that are insufficiently diversified is higher than portfolio firms that are

sufficiently diversified. Specialization at a particular growth stage and industry has a strong correlation

with the results of an investment in a portfolio. However, due to the active participation of classic venture capitalists in post-investment activities, when venture capitalists are observed individually, it is

natural that there are limits to the number of possible portfolio firms that can be supported.

Therefore, the specialized investment strategy of classic venture capitalists is supported by a

resource-based approach. Classic venture capitalists that adopt this specialized investment strategy

require a high level of valuation capability.

1.3. Value protecting or value adding -post investment activities-

There is the existence of an issue of whether the post-investment activities of venture capitalists

involve value protection or value addition (Manigart et al., 2002). Prior studies involving the

post-investment activities of venture capitalists usually centre on research approaches which focus on

value protecting and research approaches which focus on value adding. For research approaches that

focus on value protecting, the function of venture capitalists is to provide capital to ventures, and to act

from the position of value protectors of the capital provided. Merchant venture capitals tend to adopt a

hands-off approach with little involvement with the portfolio firms, or a reactive approach with

involvement only in times of emergencies. However, a value adding approach would involve the

venture capitalists participating in more functions than simple capital provision, from the viewpoint of value adding, and classic venture capitalists, which take a hands-on approach, will have active

involvement with the portfolio firms. In this kind of research approach, focus is on the involvement of

the venture capitalists outside of capital provision.

1.3.1. Value protecting

Venture capitalists, as value protectors, take the function of reducing agency costs between

investors and entrepreneurs. The moral hazard in venture capital investment is the phenomenon of

entrepreneurs not participating in behavior that will benefit investors. The function of venture

capitalists as principals is more to reduce the agency costs than to closely monitor the entrepreneurs as

agents. Entrepreneurs that have information that will result in personal benefits but represent low

returns for investors will hope to continue their enterprise and tend to pursue the strategy that will result in an increase in their own value at the cost of loss to investors. As such, there is concern that

venture capitalists will not produce a perfect mutually-dependent relationship between entrepreneur’s

personal benefits and investor returns (Gompers, 1995).

From the context of agency theory, the bulk of research tends to focus on value protection of

venture capitalists. According to Gompers, an empirical study based on 794 firms that received

investments from venture capitalists from 1961 to 1992 showed that as the lower the proportion of tangible assets belonging to industry of portfolio firms, the shorter the period till the next investment.

Furthermore, the earlier the stage of the firms and the lower the ratio of tangible assets, the higher the proportion of options and specialty of the assets. Due to this, information asymmetries are highly significant, with venture capitalists concentrating investments in early stage companies and high-tech firms where monitoring is more valuable. Monitoring contributes to the increase in value of portfolio firms if appropriately conducted (Gompers, 1995). According to Lerner, in an empirical study consisting of 271 biotechnology venture firms from 1978 to 1989, apart from the periods of time immediately prior to and after the changing of a CEO, board members additionally dispatched by the venture capital averaged at 0.24 people, while this number increased to 1.75 people around the time of CEO changes. It was further pointed out that during the period of CEO change, in which the need for monitoring became especially high, there was much higher participation of venture capitalists in the board of directors of their portfolio firms. Lerner also showed that for more experienced venture capitalists, there was a strong trend of selecting venture capitalists/firms with the same amount of experiences as syndicate partners, and the formation of venture capitalists’ syndicates are one of the major reasons for the improvement of accuracy in monitoring (Lerner, 1995).

1.3.2. Value adding

With respect to venture capitalists functions outside of capital provision, research by those

holding the viewpoint that venture capitalists add value are theoretically supported by the concept that

classic venture capitalists act with a hands-on approach. With respect to research that takes an

approach with a focus on value protecting, for venture capitalists as investors, there is a trend of an

assumption that there is no direct influence on the ability of entrepreneurs to generate returns.

However, for an approach which focuses on the value adding aspect of venture capitalists, there is the

assumption that it is possible to directly influence the ability of entrepreneurs to generate returns, and

this is supported by a resource based approach (Manigart et al, 2002). According to Barney, "sources

of sustained competitive advantage are firm resources that are valuable, rare, imperfectly imitable, and

non-substitutable. These resources include a broad range of organizational, social, and individual

phenomena within firms that are the subject of great deal of research in organization theory and

organizational behavior may be a rich source of findings and theories concerning rare, non-imitable, and non-substitutable resources in firms” (Barney, 1991), and that the resource-based approach of

sustained competitive advantage of firms has usability. Nonaka and Takeuchi indicate that

resource-based approach sees competencies, capabilities, skills, or strategic assets as the source of

sustainable competitive advantage for the firm (Nonaka and Takeuchi, 1995).

According to Brav and Gompers, in a study that followed the long-term stock value in newly listed firms from 1976 to 1994, it was found that when analyzing the relationship with

venture capital investments, poor stock performance of newly listed firms are shown by small-scale

firms with no investments from venture capitalists, and that newly listed portfolio firms of venture

capitalists show higher performance than those firms with no investments (Brav and Gompers, 1997).

According to Hata and Higashide, in Europe and the U.S, the quality of value adding activities are the

most important point for evaluating venture capital and venture capitalists (Hata and Higashide, 2000).

There are numerous studies that have shown that venture capitalists add value to portfolio firms during

post-investment activities based on specialized knowledge (Jain and Kini, 1994, Hellmann, 2000,

Hellmann and Puri, 2002).

With regard to the value-adding abilities of venture capitalists, Barney Jay B., Lowell W.

Busentiz, James O. Fiet and Douglas D. Moesel conducted an empirical study that analyzed the

learning effectiveness of the management team of ventures based on advice and support from venture

capitalists, in a sample of 203 portfolio firms in the U.S. In that study it was found that ventures with

management teams with longer industry experience and team tenure would be less likely to accept

business management advice and operational assistance from venture capitalists. However, ventures

with management teams that had previously worked together and held primary experience from

another industry were more open to business management advice from venture capitalists and also

that appropriate levels of support from the venture capitalists were dependent on the openness of the

venture with respect to learning (Barney et al., 1996). According to Higashide and Birley, high levels

of involvement of venture capitalists with portfolio firms need to be supplemented by “good

interpersonal relationships between the venture capitalists and the portfolio firm team members. In a

later empirical study that focused on venture capitalists in England, Higashide and Birley pointed out

that while it is possible for conflicting opinions to positively affect venture performance, conflict at the

personal level can negatively affect performance (Higashide and Birley, 2002). According to Busenitz, Lowell W., James O. Fiet and Douglas D. Moesel, in a study from 1987 to 1989 that focused on the

long-term performance of 235 portfolio firms under venture capitalists in the U.S., in a correlation

analysis of the provision of strategic information from venture capitalists, rotation of the management

team, and the procedural just interventions of the venture capitalists and management team, it was

found that only the procedural just interventions were significantly associated with improved

performance, which this points to the importance of this aspect in the involvement of venture

capitalists(Busenitz, et al., 2004). De Clercq and Sapienza, in an empirical research that focused on

298 venture capitalists in the U.S., showed that the social capital formed by the venture capital firm

and portfolio firms, as well as the level of involvement of the venture capital firm in portfolio firms are

strongly correlated to the performance recognition of portfolio firms under venture capital firms (De

Clercq and Sapienza, 2006).

2. **The functions of venture capitalists and technology of their portfolio firms**

2.1. Factors of new technology

According to Pfirrmann et al, new technology based firms perform complex innovation projects, therefore incurring high innovation risks (such as commercialization of technology, marketing) and business risks (bankruptcy of firms). New technology based firms have a high demand for capital that

remains liquid in the long term. Ascertaining the risk and future development of firms, as well as

estimating the total essential capital required is very difficult for investors, especially indirect financial

institutions. Together with the absence of real assets, banks are hesitant to finance the initial

developmental phases of new technology based firms. However, the injection of capital to the

portfolio firms needed to deal with financial problems may not be reduced or spread over a long time

as there is the risk that innovations would not occur favorably, or competitive advantages gained over

competitors may be lost (Pfirrmann et al., 1997). Also, they pointed out 3 factors of new technology

based firms' risk include innovation risk (commercialization of technology, marketing), business risk

(bankruptcy of firms) and financial risk involving large sums of R&D capital.

With respect to innovation risk (commercialization of technology, marketing), Baum and

Silverman state that new technology in particular is dangerous with high risk (Baum and Silverman,

2004), with the reasons being that market based on new technology is still undeveloped and

unforeseeable, and the blinding speed at which new technology becomes obsolete. According to

Kirihata, nanotechnology2)

, as one of the domains in promising new technology, breakthrough developments in fullerene and carbon nanotubes occur one after another, showing the high speed of obsolescence and stiff competition including materials and manufacturing machines that exists in the domains of new technology, thereby pointing out high risks in enterprises based on new technology (Kirihata, 2005).

For “financial risk”, Hata and Higashide point out that investments in new technology based firms that are based in new technologies such as IT, biotechnology and nanotechnology, that in order to start up an enterprise in a short period of time in a market with changes, there is high requirements for not only manpower but also massive amounts of capital injection. As such, this increases financial risk. Furthermore, they also pointed out that highly innovative ventures have more potential to mature, and if they succeed will be able to produce high returns (Hata and Higashide, 2000).

According to Kazusa, the life cycle of ventures consists of start-up, maturation, stability and degeneration, and furthermore, a special characteristic is that there is a necessity for large sums of R&D capital during the initial stages. In the case of entrepreneurs who are able to use one’s own resources, this is not such a problem but such cases are rare. For most entrepreneurs, the procurement

of capital is of the upmost importance (Kazusa, 2003). According to Hasegawa, in the case of U.S.

venture capitalists, high-tech firms (biotechnology, nanotechnology and IT), when compared to

traditional firms, require much higher amounts of capital during initial stages, and there is a necessity

to conquer this “Valley of Death” (Hasegawa, 2004). Furthermore, in new technology based firms

investments, the newer the technology and the earlier the stage, the higher the amount of capital

required.

2.2. Necessary abilities for investing in new technology based firms

2) OECD (2003) defines nanotechnology as a range of new technologies that aim to manipulate

individual atoms and molecules in order to create new products and processes: computers that fit on

the head of a pin or structures that are built from the bottom up, atom-by-atom.

Baum and Silverman, in a study of venture capitalists that invest in biotechnology firms in

Canada, analyzed if success is due to venture capitalists selecting excellent entrepreneurs or the

presence of strong support after investments. First, in an analysis of the valuation of main potentials of technology start-ups, in addition to showing the framework that consists of alliance capital, intellectual

capital and human capital, venture capitalists affect selection both by acting as a scout that can identify

future potential in excellent technologies as well as a coach to help realize this potential by imparting

management skills (Baum and Silverman, 2003).

Furthermore, Masuda claimed that for venture capitalists that focus their investments mostly on

high-tech start-ups, in addition to digging out promising ventures, providing capital and support, there

is a requirement for the ability to be selected as partners by researchers who produce the cutting-edge

technology, to plan enterprise concepts, and to assemble an entrepreneur team (Masuda, 2006).

Hasegawa also pointed out that the important functions for such venture capitalists include strategic

planning, advice as a mentor, marketing, finance and recruitment. Furthermore, in a comparison of

Japan's venture capitalists and U.S. venture capitalists, in the case of high-tech industries such as

biotechnology, nanotechnology, IT, it is essential to recruit specialists with specialized skills, but in the

case of ventures in Japan, it is difficult to procure specialists even if headhunting companies are used.

In Japan, it is important for venture capitalists, in addition to introducing appropriate human resource using networks in the industry, to judge the competency of company executives to offer counsel

regarding replacements, and in general support human resource (Hasegawa, 2004).

BENEFITS OF MERCHANT BANKING

Venture capital funding is one such way of borrowing money from investors. But why is it a more attractive option over other funding sources? We'll discuss them below in the benefits of venture capital funding:

1. It provides you with capital without selling equity. Venture capital funding is essentially a debt that your company makes. That said, you should pay for that debt in whole plus interest. This is beneficial to startup companies who would like extra capital without having to sell off equity and retain total control over the company.

2. It provides you with alternative funding options. While venture capital funding can help keep yourself from selling equity, you can also mix the two depending on your needs and priorities. For example, you can sell equity in order to minimize your risk of loss in the company, while, at the same time, apply for venture capital funding in order to acquire new equipment such as computers for your office.

3. It provides you with more money with which to expand. This is the most obvious benefit of getting money from venture capital funding. You do not necessarily have to be in the red to ask for this type of funding. You can also use the capital in order to expand your business—you can buy new equipment, improve your research and development, or some other aspect of your business with the extra capital. You may also choose to use the money as a form of insurance just in case your company runs the risk of losing money somewhere along the way.

There you have it, some of the most important benefits of **venture capital funding**. This way of raising capital is especially attractive if you are just starting out your company. It can help you with the much needed expansion that's critical at this stage of your company's growth without having to sell equity. You also have the alternative of mixing venture capital funding with other funding sources, which provides you with more flexibility on how you spend your money.

Keep in mind, however, that the venture capital funding that you'll get is only as good as the financing institution you're working with. Therefore, make sure that you only work with those with a proven track record and ideally work in the industry you're in.

MUTUAL FUNDS

Definition of 'Mutual Fund'

An investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus.

TYPES OF MUTUAL FUNDS

No matter what type of investor you are, there is bound to be a mutual fund that fits your style. According to the last count there are more than 10,000 mutual funds in North America! That means there are more mutual funds than stocks. (For more reading see *Which Mutual Fund Style Index Is For You?*)

It's important to understand that each mutual fund has different risks and rewards. In general, the higher the potential return, the higher the risk of loss. Although some funds are less risky than others, all funds have some level of risk - it's never possible to diversify away all risk. This is a fact for all investments.

Each fund has a predetermined investment objective that tailors the fund's assets, regions of investments and investment strategies. At the fundamental level, there are three varieties of mutual funds:

1) Equity funds (stocks)
2) Fixed-income funds (bonds)
3) Money market funds

All mutual funds are variations of these three asset classes. For example, while equity funds that invest in fast-growing companies are known as growth funds, equity funds that invest only in companies of the same sector or region are known as specialty funds.

Let's go over the many different flavors of funds. We'll start with the safest and then work through to the more risky.

Money Market Funds
The money market consists of short-term debt instruments, mostly Treasury bills. This is a safe place to park your money. You won't get great returns, but you won't have to worry about losing your principal. A typical return is twice the amount you would earn in a regular checking/savings account and a little less than the average certificate of deposit (CD).

Bond/Income Funds
Income funds are named appropriately: their purpose is to provide current income on a steady basis. When referring to mutual funds, the terms "fixed-income," "bond," and "income" are synonymous. These terms denote funds that invest primarily in government and corporate debt. While fund holdings may appreciate in value, the primary objective of these funds is to provide a steady cashflow to investors. As such, the audience for these funds consists of conservative investors and retirees. (Learn more in*Income Funds 101*.)

Bond funds are likely to pay higher returns than certificates of deposit and money market investments, but bond funds aren't without risk. Because there are many different types of bonds, bond funds can vary dramatically depending on where they invest. For example, a fund specializing in high-yield junk bonds is much more risky than a fund that invests in government securities. Furthermore, nearly all bond funds are subject to interest rate risk, which means that if rates go up the value of the fund goes down.

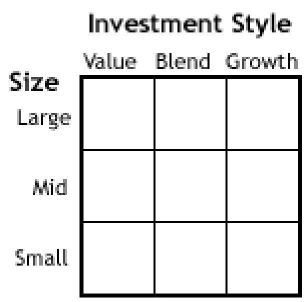
Balanced Funds

The objective of these funds is to provide a balanced mixture of safety, income and capital appreciation. The strategy of balanced funds is to invest in a combination of fixed income and equities. A typical balanced fund might have a weighting of 60% equity and 40% fixed income. The weighting might also be restricted to a specified maximum or minimum for each asset class.

A similar type of fund is known as an asset allocation fund. Objectives are similar to those of a balanced fund, but these kinds of funds typically do not have to hold a specified percentage of any asset class. The portfolio manager is therefore given freedom to switch the ratio of asset classes as the economy moves through the business cycle.

Equity Funds

Funds that invest in stocks represent the largest category of mutual funds. Generally, the investment objective of this class of funds is long-term capital growth with some income. There are, however, many different types of equity funds because there are many different types of equities. A great way to understand the universe of equity funds is to use a style box, an example of which is below.



The idea is to classify funds based on both the size of the companies invested in and the investment style of the manager. The term value refers to a style of investing that looks for high quality companies that are out of favor with the market. These companies are characterized by low P/E and price-to-book ratios and high dividend yields. The opposite of value is growth, which refers to companies that have had (and are expected to continue to have) strong growth in earnings, sales and cash flow. A compromise between value and growth is blend, which simply refers to companies that are neither value nor growth stocks and are classified as being somewhere in the middle.

For example, a mutual fund that invests in large-cap companies that are in strong financial shape but have recently seen their share prices fall would be placed in the upper left quadrant of the style box (large and value). The opposite of this would be a fund that invests in startup technology companies with excellent growth prospects. Such a mutual fund would reside in the bottom right quadrant (small and growth). (For further reading, check out *Understanding The Mutual Fund Style Box*.)

Global/International Funds
An international fund (or foreign fund) invests only outside your home country. Global funds invest anywhere around the world, including your home country.

It's tough to classify these funds as either riskier or safer than domestic investments. They do tend to be more volatile and have unique country and/or political risks. But, on the flip side, they can, as part of a well-balanced portfolio, actually reduce risk by increasing diversification. Although the world's economies are becoming more inter-related, it is likely that another economy somewhere is outperforming the economy of your home country.

Specialty Funds
This classification of mutual funds is more of an all-encompassing category that consists of funds that have proved to be popular but don't necessarily belong to the categories we've described so far. This type of mutual fund forgoes broad diversification to concentrate on a certain

segment of the economy.

Sector funds are targeted at specific sectors of the economy such as financial, technology, health, etc. Sector funds are extremely volatile. There is a greater possibility of big gains, but you have to accept that your sector may tank.

Regional funds make it easier to focus on a specific area of the world. This may mean focusing on a region (say Latin America) or an individual country (for example, only Brazil). An advantage of these funds is that they make it easier to buy stock in foreign countries, which is otherwise difficult and expensive. Just like for sector funds, you have to accept the high risk of loss, which occurs if the region goes into a bad recession.

Socially-responsible funds (or ethical funds) invest only in companies that meet the criteria of certain guidelines or beliefs. Most socially responsible funds don't invest in industries such as tobacco, alcoholic beverages, weapons or nuclear power. The idea is to get a competitive performance while still maintaining a healthy conscience.

Index Funds
The last but certainly not the least important are index funds. This type of mutual fund replicates the performance of a broad market index such as the S&P 500 or Dow Jones Industrial Average (DJIA). An investor in an index fund figures that most managers can't beat the market. An index fund merely replicates the market return and benefits investors in the form of low fees.

SECURITIZATION OF MUTUAL FUNDS

Standard & Poor's Ratings Services
is monitoring regulatory discussions surrounding the guidelines that govern how mutual funds charge 12b-1 fees to investors. 12b-1 fees are deferred fees charged by mutual funds to cover certain administrative, marketing, and sales expenses. The SEC has stepped up its discussions on the topic lately, and possible reforms could have an impact on the ratings Standard & Poor's assigns

to securitized 12b-1 fee trusts.

Tranches in 12b-1 fee trusts generally cannot achieve ratings at the 'AAA' level under Standard & Poor's current criteria due to the risks we believe are posed by potential changes in the regulatory framework for mutual funds. Periodic regulatory discussions over the past several years have reinforced these considerations. Most recently, SEC chairman Mary Shapiro commented "We need to critically rethink how 12b-1 fees are used and whether they remain appropriate," as reported in the July 6, 2010, issue of The Wall Street Journal.

It's currently uncertain whether regulatory change will occur and in what form. Therefore, the potential effect of any such regulatory change on the outstanding ratings is unknown.

The outstanding rated 12b-1 fee trusts are backed by fees on static pools of mutual fund shares. The performance of the trusts does not depend on the issuance of new shares under the 12b-1 regulation. Therefore, unless regulation alters fees paid by outstanding shares, it's unlikely that the transactions, or their current ratings, would be affected solely as a result of the regulation. Additionally, these transactions typically mature after eight years, as that is the maximum period mutual funds can collect 12b-1 fees. Depending on the timing of any possible new regulations, the outstanding transactions may have time to repay their notes before regulatory changes take effect.

Standard & Poor's will continue to monitor developments in this area. As more information about regulatory changes becomes known, we will take appropriate rating actions as they are warranted. We will also continue to monitor the performance of this asset class and provide market updates as needed.

CREDIT RATING

A **credit rating** evaluates the credit worthiness of a debtor, especially a business (company) or a government. It is an evaluation made by a credit rating agency of the debtor's ability to pay back the debt and the likelihood of default.[3]

Credit ratings are determined by credit ratings agencies. The credit rating represents the credit rating agency's evaluation of qualitative and quantitative information for a company or government; including non-public information obtained by the credit rating agencies analysts.

Credit ratings are not based on mathematical formulas. Instead, credit rating agencies use their judgment and experience in determining what public and private information should be considered in giving a rating to a particular company or government. The credit rating is used by individuals and entities that purchase the bonds issued by companies and governments to determine the likelihood that the government will pay its bond obligations.

A poor credit rating indicates a credit rating agency's opinion that the company or government has a high risk of defaulting, based on the agency's analysis of the entity's history and analysis of long term economic prospects.

A **sovereign credit rating** is the credit rating of a sovereign entity, i.e., a national government. The sovereign credit rating indicates the risk level of the investing environment of a country and is used by investors looking to invest abroad. It takes political risk into account

The table shows the ten least-risky countries for investment as of June 2012. Ratings are further broken down into components including political risk, economic risk. Euromoney's bi-annual country risk index[6] monitors the political and economic stability of 185 sovereign countries. Results focus foremost on economics, specifically sovereign default risk and/or payment default risk for exporters (a.k.a. "trade credit" risk).

A. M. Best defines "country risk"[7] as the risk that country-specific factors could adversely affect an insurer's ability to meet its financial obligations

Short-term rating

A short-term rating is a probability factor of an individual going into default within a year. This is in contrast to long-term rating which is evaluated over a long timeframe. In the past institutional investors preferred to consider long-term ratings. Nowadays, short-term ratings are commonly used.

First, the Basel II agreement requires banks to report their one-year probability if they applied internal-ratings-based approach for capital requirements. Second, many institutional investors can easily manage their credit/bond portfolios with derivatives on monthly or quarterly basis. Therefore, some rating agencies simply report short-term ratings.

Corporate credit ratings

The credit rating of a corporation is a financial indicator to potential investors of debt securities such as bonds. Credit rating is usually of a financial instrument such as a bond, rather than the whole corporation. These are assigned by credit rating agencies such as A. M. Best, Dun & Bradstreet, Standard & Poor's, Moody's or Fitch Ratings and have letter designations such as A, B, C. The Standard & Poor's rating scale is as follows, from excellent to poor: AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, CC, C, D. Anything lower than a BBB- rating is considered a speculative or junk bond.[8] The Moody's rating system is similar in concept but the naming is a little different. It is as follows, from excellent to poor: Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3, Ba1, Ba2, Ba3, B1, B2, B3, Caa1, Caa2, Caa3, Ca, C.

A. M. Best rates from excellent to poor in the following manner: A++, A+, A, A-, B++, B+, B, B-, C++, C+, C, C-, D, E, F, and S. The CTRISKS rating system is as follows: CT3A, CT2A, CT1A, CT3B, CT2B, CT1B, CT3C, CT2C and CT1C. All these CTRISKS grades are mapped to one-year probability of default.

CARE

Overview

CARE Ratings commenced operations in April 1993 and over nearly two decades, it has established itself as the second-largest credit rating agency in India. With the rating volume of debt of around Rs.44,051 bn (as on September 30, 2012) , CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings has also emerged as the leading agency for covering many rating segments like that for banks, sub-sovereigns and IPO gradings.

CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

With majority shareholding by leading domestic banks and financial institutions in India, CARE's intrinsic strengths have also attracted many other investors.

CARE's registered office and head office, is located at 4th floor, Godrej Coliseum, Somaiya Hospital Road, Sion (East), Mumbai 400 022. In addition, CARE has regional offices at Ahmedabad, Bangalore, Chennai, Hyderabad, Jaipur, Kolkata, New Delhi, Pune and international operation in Male in the Republic of Maldives. With independent and unbiased credit rating opinions forming the core of its business model, CARE Ratings has the unique advantage in the form an External Rating Committee to decide on the ratings. Eminent and experienced professionals constitute CARE's Rating Committee.

ICRA

ICRA Limited (formerly Investment Information and Credit Rating Agency of India Limited) was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional Investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange.

Alliance with Moody's Investors Service

The international Credit Rating Agency Moody's Investors Service[1] is ICRA's largest shareholder. The participation of Moody's is supported by a Technical Services Agreement, which entails Moody's providing certain high-value technical services to ICRA. Specifically, the agreement is aimed at benefiting ICRA's in-house research capabilities, and providing it with access to Moody's global research base. The agreement also envisages Moody's conducting regular training and business seminars for ICRA analysts on various subjects to help them better understand and manage concepts and issues relating to the development of the capital markets in India. Besides this formal training programme, the agreement provides for Moody's advising ICRA on Rating-products strategy, and the Ratings business in general.

The ICRA Factor

Facilitating Efficiency in Business...
ICRA information products, Ratings, and solutions reflect independent, professional and impartial opinions, which assist businesses enhance the quality of their decisions and help issuers access a broader investor base and even lesser known companies approach the money and capital markets.

The Research Factor...
We strongly believe that the quality of analytical output is a derivative of an organisation's research capabilities. We have dedicated teams for Monetary, Fiscal, Industry and Sector research, and a panel of Advisors to enhance our in-house capabilities. Our research base enables us to maintain the highest standards of quality and credibility.

Committed to the Development of the Financial Market...
The focus of ICRA in the coming years will continue to be on developing innovative concepts and products in a dynamic market environment, generating and promoting wider investor awareness and interest, enhancing efficiency and transparency in the financial market, and providing a healthier environment for market participants and regulators.

Our Products and Services are Designed to:

Provide information and guidance to institutional and individual investors/creditors;

Enhance the ability of borrowers/issuers to access the money market and the capital market for tapping a larger volume of resources from a wider range of the investing public;

Assist the regulators in promoting transparency in the financial markets; and

Provide intermediaries with a tool to improve efficiency in the funds raising process.

ICRA's Position on AACRA Best Practices Checklist

Range of Services

Rating Services

As an early entrant in the Credit Rating business, **ICRA Limited (ICRA)** is one of the most experienced Credit Rating Agencies in the country today. ICRA rates rupee denominated debt instruments issued by manufacturing companies, commercial banks, non-banking finance companies, financial institutions, public sector undertakings and municipalities, among others. ICRA also rates structured obligations and sector-specific debt obligations such as instruments issued by Power, Telecom and Infrastructure companies. The other services offered include Corporate Governance Rating, Stakeholder Value and Governance Rating, Credit Risk Rating of Debt Mutual Funds, Rating of Claims Paying Ability of Insurance Companies, Project Finance Rating, and Line of Credit Rating. ICRA, along with National Small Industries Corporation Limited (NSIC), offers a Performance and Credit Rating Scheme for Small-Scale Enterprises in India. The service is aimed at enabling Small and Medium Enterprises (SMEs) improve their access to institutional credit, increase their competitiveness, and raise their market standing.

PT. ICRA Indonesia (ICRAIndo), a subsidiary of ICRA, offers a wide range of Rating services in the Indonesian market, including Credit Rating of rupiah-denominated debt instruments issued by manufacturing companies, banks, finance companies and financial institutions; Issuer Rating of corporate entities, banks & financial institutions, service companies, infrastructure sector companies, multi-finance companies, and small & medium sector companies; Structured Finance Rating of asset-backed securitisation and mortgage-backed securitization programmes, among others; Lines of Credit Rating based on the Basel II Accord; Project Finance Rating;Mutual Funds Rating; and Claims Paying Ability Rating of insurance companies.

ICRA Lanka Limited (ICRALanka), a wholly-owned subsidiary of ICRA, offers a wide range of Rating services in the Sri Lankan market, putting into use parent ICRA’s accumulated experience in the areas of Credit Rating, Grading, and Investment Information. Its Rating focus is on entities mainly in the financial sector, besides long-, medium-, and short-term debt instruments issued by borrowers from various sectors of the economy.

Grading Services

The Grading Services offered by **ICRA** employ pioneering concepts and methodologies, and include Grading of: Initial Public Offers (IPOs); Microfinance Institutions (MFIs); Construction Entities; Real Estate Developers and Projects; Healthcare Entities; and Maritime Training Institutes. In IPO Grading, an ICRA-assigned IPO Grade represents a relative assessment of the “fundamentals” of the issue graded in relation to the universe of other listed equity securities in India. In MFI Grading, the focus of ICRA’s grading exercise is on evaluating the candidate institution’s business and financial risks. The Grading of Construction Entities seeks to provide an independent opinion on the quality of performance of the entities graded. Similarly, the Grading of Real Estate Developers and Projects seeks to make property buyers aware of the risks associated with real estate projects, and with the developers' ability to deliver in accordance with the terms agreed. ICRA's Healthcare Gradings present an independent opinion on the quality of care provided by healthcare entities. In the education sector, ICRA offers the innovative service of Grading of Maritime Training Institutes in India.

Consulting Services

ICRA Management Consulting Services Limited (IMaCS), a wholly-owned subsidiary of ICRA Limited, is a multi-line management and development consulting firm with a global operating footprint. IMaCS offers Consulting Services in Strategy, Risk Management, Regulation & Reform, Transaction Advisory, Development Consulting and Process Re-engineering. IMaCS' clientele includes Banks and Financial Service Companies, Corporate Entities, Institutional Investors, Governments, Regulators, and Multilateral Agencies. Besides India, IMaCS has consulting experience across 35 countries in South East Asia, Northern Asia, West Asia, Africa, Western Europe, and North America.

Software Development, Business Intelligence and Analytics and Engineering Services

ICRA Techno Analytics Limited (ICTEAS), a wholly-owned subsidiary of ICRA Limited, offers a complete portfolio of Information Technology (IT) solutions to meet the dynamic needs of present-day businesses. The services range from the traditional development of client-server, web-centric and mobile applications to the generation of cutting-edge Business Intelligence applications and analytics solutions. With years of experience in data-mining and predictive data modelling, ICTEAS offers various analytics solutions such as sales analytics and spend analytics. An in-depth knowledge of various technology areas, coupled with its strengths in various verticals, enables ICTEAS provide end-to-end services of excellent quality. It uses a mix of onsite/offshore strategies to optimise bottom-line benefits for its customers. ICTEAS is a Microsoft Gold Partner and is ISO 27001 certified.

The Engineering Division of ICTEAS offers multidisciplinary computer aided engineering design services. The activities cover design and drawing in the mechanical, civil/structural, electrical and instrumentation space. ICTEAS engineers and designers are well-versed in AutoCAD, MicroStation, PDS and Staad pro with experience in the Oil & Gas, Petrochemical and Power Sectors. The services range from providing Engineering Design Services to CAD

Vectorisation and Conversion Services. Over the years, ICTEAS has successfully deployed skilled resources to work for large engineering consulting companies both in the domestic and international market.

ICTEAS has two subsidiaries, **ICRA Sapphire Inc. (ICSAP)** and **Axiom Technologies Limited (AXIOM)**. ICSAP is based in Connecticut, USA, while AXIOM operates out of Kolkata, India.

ICSAP, a wholly-owned subsidiary of ICTEAS, offers US clients a full array of leading edge Business Analytics and Software Development services backed by offshore teams, which work out of ICTEAS, Kolkata. This hybrid engagement model of onsite and offshore teams allows for seamless project management, execution and rapid offshore scaling of teams while bringing down development costs.

Based on the experience gained from working with the City of New York in the tragic days after the World Trade Center attacks, ICSAP developed for New York City the Unified Victim Identification System (UVIS), a Disaster Response Solution. ICSAP is now implementing UVIS in other states. ICSAP Analytics helps companies make meaning out of their data and bring visibility on their business, thus allowing them to modify their strategy for better Returns on Investment. ICSAP services various verticals, including state and city Governments, besides Finance, Banking, Life Sciences and Healthcare, Manufacturing, Law and Internet companies.

AXIOM, a wholly-owned subsidiary of ICTEAS, specialises in customisation and implementation services on the Oracle E-Business Suite. Its services include process study, fitment analysis, customisation, implementation and post-implementation maintenance services. AXIOM focuses on the Financial Modules of the Oracle E-Business Suite, which include Order Management, General Ledger, Accounts Payable, Accounts Receivable, Cash Management, Purchasing and Inventory, Fixed Assets and Global Consolidation.

Knowledge Process Outsourcing and Online Software

ICRA Online Limited (ICRON) is a wholly-owned subsidiary of ICRA Limited. ICRON was incorporated in January 1999 and has over the period since then established itself as an independent and credible source of authentic information, software and outsourcing solutions provider.

ICRON caters for some of the biggest names in the financial services sector in India and abroad, which is a testimony to its product quality, commitment and credibility. ICRON has two Strategic Business Units (SBUs) with a list of reputed global and domestic clients:

- **The Knowledge Process Outsourcing Division (KPO Division); and**
- **The Information Services and Technology Solutions Division (MFI Division).**

Encouraged by the emerging dynamics of the outsourcing business, ICRON diversified into the **Knowledge Process Outsourcing (KPO)** business in April 2004, with focus on the Banking, Financial Services and Insurance (BFSI) vertical as well as other verticals like Retail, Healthcare and Pharmaceuticals.

The **KPO Division** of ICRON offers Knowledge Process Outsourcing services that combine advanced analytical abilities and deep domain expertise to deliver value by translating data and information into structured business inputs. It provides back-end analytical services support to its clients in the areas of Data Extraction, Aggregation, Validation and Analysis, Accounting and Finance, Research, Report Preparation and Modelling. The Division has attained ISO 27001 certification through rigorous adherence to data security policies and practices.

The **MFI Division** serves the Mutual Fund Industry through Research, Analytics and Mutual Fund Ranking. Besides, it leverages its domain expertise to deliver high quality technology solutions, in the form of products, to a large number of Banks, Mutual Funds, Financial Institutions, Third Party Products' Distributors, Insurance Companies, Investment Advisors, Portfolio Managers, Stock Brokers, Treasury Managers, and Academic Institutions, among others. The Company has developed several innovative products to meet the varied needs of its clients. The products are customised to meet specific client requirements, enabling them in research, analysis and decision making while also helping them achieve automation in business operations.

CRISIL

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services.

They are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations. With sustainable competitive advantage arising from our strong brand, unmatched credibility, market leadership across businesses, and large customer base, we deliver analysis, opinions, and solutions that make markets function better.

their defining trait is our ability to convert data and information into expert judgements and forecasts across a wide range of domains, with deep expertise and complete objectivity.

At the core of our credibility, built up assiduously over the years, are their values: Integrity, Independence, Analytical Rigour, Commitment and

Innovation.

CRISIL's majority shareholder is Standard and Poor's (S&P). Standard & Poor's, a part of The McGraw-Hill Companies (NYSE:MHP), is the world's foremost provider of credit ratings.

Who they Serve
We address a rich and globally diversified client base. Within India our customers range from small enterprises to the largest corporations and financial institutions; outside India our customers include the world's largest banks and leading corporations. We also work with governments and policy-makers in India and other emerging markets in the infrastructure domain.

How they Add Value
We empower our customers, and the markets at large, with independent analysis, benchmarks and tools. These help lenders and borrowers, issuers and investors, regulators, and market intermediaries make better-informed investment and business decisions. Our offerings allow markets and market participants to become more transparent and efficient - by mitigating and managing risk, taking pricing decisions, generating more revenue, reducing time to market and enhancing returns. By helping shape public policy on infrastructure in emerging markets, we help catalyse economic growth and development in these countries.

END OF 1ST UNIT