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Vardhaman Mahaveer Open University, Kota

Capital Market and SEBI Regulations

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Unit : 1 - Overview of Capital Market

Structure of Unit:

1.0 Objectives

After going through this Unit the student will be able to understand: what actually Capital Market is. The major securities market reforms taken by SEBI, the role of IOSCO in securities market regulation and the overview of depository system in India.

1.1 Introduction

The Capital Market is a market for financial investments that are direct or indirect claims to capital. It embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument. The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred. Every modern economy is based on a sound financial system which helps in production, capital and economic growth by encouraging savings habits, mobilising savings from households and other segments and allocating savings into productive usage such as trade, commerce, manufacture etc. Financial system covers both credit and cash transactions. All financial transactions are dealt with by cash payment or issue of negotiable instruments like cheque, bills of exchanges, etc. Thus a financial system is a set of institutional arrangements through which financial surpluses are mobilised from the units generating surplus income and transferring them to the others in need of them. The activities include production, distribution, exchange and holding of financial assets/instruments of different kinds by financial institutions, banks and other intermediaries of the market. In a nutshell, financial market, financial assets, financial services and financial institutions constitute the financial system.

Various factors influence the capital market and its growth. These include level of savings in the household sector, taxation levels, and health of economy, corporate performance, industrial trends and common patterns of living. The strength of the economy is calibrated by different economic indicators like growth in GDP (Gross Domestic Product), Agricultural production, quantum and spread of rain fall, interest rates, inflation, position on balance of payments and balance of trade, levels of foreign exchange reserves and investments and growth in capital formation. The traditional form of financing companies projects consist of internal resources and debt financing, particularly from financial institutions for modernisation, expansion and diversification. The upsurge in performance of certain large companies and the astounding increase of their share prices boost the market sentiment to divert the savings more and more into equity investments in companies. This lead to the growth of equity cult among investors to contribute resources not only for companies but even for financial institutions and banks. The functions of a good financial system are manifold. They are: regulation of currency, banking functions, performance of agency services and custody of cash reserves, management of national reserves of international currency, etc. similarly Long term growth of financial system is ensured through: education of investors, giving autonomy to FIs to become efficient under competition, consolidation through mergers etc.

1.2 Organisational Structure of Financial System

Organisational structure of financial system includes components i.e., Financial Markets, Products and Market Participants.

Financial Markets-Stated formally, financial markets provide channels for allocation of savings to investment. These provide a variety of assets to savers as well as various forms in which the investors can raise funds and thereby decouple the acts of saving and investment. The financial markets, thus, contribute to economic development to the extent that the latter depends on the rates of savings and investment. The financial markets have two major components; the money market and the capital market.

The Money market refers to the market where borrowers and lenders exchange short-term funds to solve their liquidity needs. Money market instruments are generally financial claims that have low default risk, maturities under one year and high marketability.

Capital Market is a market for financial investments that are direct or indirect claims to capital. It is wider than the Securities Market and embraces all forms of lending and borrowing, whether or not evidenced by the creation of a negotiable financial instrument. The Capital Market comprises the complex of institutions and mechanisms through which intermediate term funds and long term funds are pooled and made available to business, government and individuals. The Capital Market also encompasses the process by which securities already outstanding are transferred.

The capital market and in particular the stock exchange is referred to as the barometer of the economy. Government's policy is so moulded that creation of wealth through products and services is facilitated and surpluses and profits are channelised into productive uses through capital market operations. Reasonable opportunities and protection are afforded by the Government through special measures in the capital market to get new investments from the public and the Institutions and to ensure their liquidity.

1.3 Need for Capital Market

Capital market is an important and efficient conduit to channel and mobilize funds to enterprises, both private and government. – It provides an effective source of investment in the economy with a view to enhancing a country's long-term growth prospects, and thus acts as a major catalyst in transforming the economy into a more efficient, innovative and competitive marketplace within the global arena. – In addition to resource allocation, capital markets also provide a medium for risk management by allowing the diversification of risk in the economy. – A well-functioning capital market tends to improve information quality as it plays a major role in encouraging the adoption of stronger corporate governance principles, thus supporting a trading environment, which is founded on integrity. – Capital market has played a crucial role in supporting periods of technological progress and economic development throughout history. – Among other things, liquid markets make it possible to obtain financing for capital-intensive projects with long gestation periods. This certainly held true during the industrial revolution in the 18th centuryand continues to apply even as we move towards the so-called "New Economy". – Capital markets make it possible for companies to give shares to their employees via ESOPs – Capital markets provide a currency for acquisitions via share swaps. – Capital markets provide an excellent route for disinvestments to take place. – Venture Capital and Private Equity funds investing in unlisted companies get an exit option when the company gets listed on the capital markets – The existence of deep and broad capital market is absolutely crucial in spurring the growth our country.

1.4 Securities Market-Primary Market and Secondary Market

The major objectives of Securities market are:

- To mobilize resources for investments.
- To facilitate buying and selling of securities.
- To facilitate the process of efficient price discovery.
- To facilitate settlement of transactions in accordance with the predetermined time schedules.

The Capital Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market. Primary Market -The primary market provides the channel for sale of new securities, while the secondary market deals in securities previously issued. The issuer of securities sells the securities in the primary market to raise funds for investment and/or to discharge some obligation. In other words, the market wherein resources are mobilised by companies through issue of new securities is called the primary market. These resources are required for new projects as well as for existing projects with a view to expansion, modernisation, diversification and upgradation.

The Primary Market (New Issues) is of great significance to the economy of a country. It is through the primary market that funds flow for productive purposes from investors to entrepreneurs. The latter use the funds for creating new products and rendering services to customers in India and abroad. The strength of the economy of a country is gauged by the activities of the Stock Exchanges. The primary market creates and offers the merchandise for the secondary market.

Secondary Market-The secondary market enables those who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The price signals, which subsume all information about the issuer and his business including, associated risk, generated in the secondary market, help the primary market in allocation of funds.

The stock exchanges are the exclusive centres for trading in securities and the trading platform of an exchange is accessible only to brokers. The regulatory framework heavily favours the recognised stock exchanges by almost banning trading activity outside the stock exchanges. The stock market or secondary market ensures free marketability, negotiability and price discharge. For these reasons the stock market is referred to as the nerve centre of the capital market, reflecting the economic trend as well as the hopes, aspirations and apprehensions of the investors.

This secondary market has further two components, first, the **spot market** where securities are traded for immediate delivery and payment, the other is **futures market** where the securities are traded for future delivery and payment. Another variant is the options market where securities are traded for conditional future delivery. Generally, two types of options are traded in the options market. A put option permits the owner to sell a security to the writer of the option at a pre-determined price before a certain date, while a call option permits the buyer to purchase a security from the writer of the option at a particular price before a certain date.

1.5 Products and Market Participants

Savings are linked to investments by a variety of intermediaries through a range of complex financial products called “securities” which is defined in the Securities Contracts (Regulation) Act, 1956 to include shares, scrips, stocks, bonds, debentures, debenture stock, or other marketable securities of like nature in or of any incorporate company or body corporate, government securities, derivatives of securities, units of collective investment scheme, security receipts, interest and rights in securities, or any other instruments so declared by the central government.

The amount of funds supplied by the supplier of funds may not be the amount needed by the supplier of securities. Similarly, the risk, liquidity and maturity characteristics of the securities may not match preference of the supplier of funds. In such cases, they incur substantial search costs to find each other. Search costs are minimised by the intermediaries who match and bring these suppliers together. They may act as agents to match the needs of the suppliers of funds / securities, help them in creation and sale of securities or buy the securities issued by supplier of securities and in turn, sell their own securities to suppliers of funds. The market does not work in a vacuum; it requires services of a large variety of intermediaries like merchant bankers, brokers, etc to bring the suppliers of funds and suppliers of securities together for a variety of transactions.

The securities market, thus, has essentially three categories of participants, namely the issuers of securities, investors in securities and the intermediaries. The issuers and investors are the consumers of services rendered by the intermediaries while the investors are consumers of securities issued by issuers. Those who receive funds in exchange for securities and those who receive securities in exchange for funds often need the reassurance that it is safe to do so. This reassurance is provided by the law and custom, often enforced by the regulator. The regulator develops fair market practices and regulates the conduct of issuers of securities and the intermediaries so as to protect the interests of investors in securities.

1.6 Securities Market and Economic Growth

A well functioning securities market is conducive to sustained economic growth. The securities market fosters economic growth to the extent that it-(a) augments the quantities of real savings and capital formation from any given level of national income, (b) increases net capital inflow from abroad, (c) raises the productivity of investment by improving allocation of investible funds, and (d) reduces the cost of capital. It is reasonable to expect savings and capital accumulation and formation to respond favourably to developments in securities market.

The availability of yield bearing securities makes present consumption more expensive relative to future consumption and, therefore, people might be induced to consume less today. The composition of savings may also change with fewer saving being held in the form of idle money or unproductive durable assets, simply because more divisible and liquid assets are available.

The securities market facilitates the internationalisation of an economy by linking it with the rest of the world. This linkage assists through the inflow of capital in the form of portfolio investment. Moreover, a strong domestic stock market performance forms the basis for well performing domestic corporate to raise capital in the international market. This implies that the domestic economy is opened up to international competitive pressures, which help to raise efficiency.

Any financial development produces allocation improvement over a system of segregated investment opportunities. The benefits of improved investment allocation is such that Mc Kinnon defines economic development as reduction of the great dispersion in social rate of return to existing and new investments under domestic entrepreneurial control. Instead of emphasising scarcity of capital, he focuses on the extra-ordinary distortions commonly found in the domestic securities markets of the developing countries. In the face of great discrepancies in rate of return, the accumulation of capital does not contribute much to development. A developed securities market successfully monitors the efficiency with which the existing capital stock is deployed.

In as much as the securities market enlarges the financial sector, promoting additional and more sophisticated financing, it increases opportunities for specialisation, division of labour and reductions in costs in financial activities. The securities market and its institutions help the user in many ways to reduce the cost of capital. They provide a convenient market place to which investors and issuers of securities go and thereby avoid the need to search a suitable counterpart. The market provides standardised products and thereby cuts the information costs associated with individual instruments. The market institutions specialise and operate on large scale which cuts costs through the use of tested procedures and routines.

1.7 Market Regulation

It is important to ensure smooth working of capital market, as it is the arena for the players associated with the economic growth of the country. Various laws have been passed from time to time to meet this objective. The financial market in India was highly segmented until the initiation of reforms in 1992-93 on account of a variety of regulations and administered prices including barriers to entry. The reform process was initiated with the establishment of Securities and Exchange Board of India.

The main legislations governing the Capital Market are:–

1. The SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market. The SEBI Act, 1992 establishes SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and also to penalise them in case of violations of the provisions of the Act, Rules and Regulations made there under. SEBI has full autonomy and authority to regulate and develop an orderly securities market.
2. The Securities Contracts (Regulation) Act, 1956, SC(R)A which regulates transactions in securities through control over stock exchanges. It provides for

direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives central government/SEBI regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with prescribed conditions of Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules.

3. The Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities. The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerializing the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with.

4. The Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities and disclosures to be made in public issues. It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.

1.8 Policy Initiatives by SEBI

SEBI has come a long way since its inception as an institution regulating the Indian Capital Markets. It has initiated a lot of reforms to make the market safer for investors. The following are the major policy initiatives taken by SEBI since its inception.

– Control over Issue of Capital: A major initiative of liberalisation was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. In the interest of investors, SEBI issued Disclosure and Investor Protection (DIP) guidelines. The guidelines allow issuers, complying with the eligibility criteria, to issue securities the securities at market determined rates. The market moved from merit based to disclosure based regulation.

- Establishment of Regulator: A major initiative of regulation was, establishment of a statutory autonomous agency, called SEBI, to provide reassurance that it is safe to undertake transactions in securities.
- Screen Based Trading: A major developmental initiative was a nation-wide on-line fully-automated screen based trading system (SBTS) where a member can punch into the computer quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching sale or buy order from a counter party.
- Risk management: A number of measures were taken to manage the risks in the market so that the participants are safe and market integrity is protected. The trading cycle varied from 14 days for specified securities to 30 days for others and settlement took another fortnight. Rolling settlement on T+5 basis was introduced in phases. All scrips moved to rolling settlement from December 2001. T+5 gave way to T+3 from April 2002 and T+2 from April 2003.
- Depositories Act: The earlier settlement system gave rise to settlement risk. This was due to the time taken for settlement and due to the physical movement of paper. Further, the transfer of shares in favour of the purchaser by the company also consumed considerable amount of time. To obviate these problems, the Depositories Act, 1996 was passed to provide for the establishment of depositories in securities.
- Derivatives: To assist market participants to manage risks better through hedging, speculation and arbitrage, SC(R)A was amended in 1995 to lift the ban on options in securities.
- Settlement Guarantee: A variety of measures were taken to address the risk in the market. Clearing corporations emerged to assume counter party risk. Trade and settlement guarantee funds were set up to guarantee settlement of trades irrespective of default by brokers. These funds provide full novation and work as central counter party. The Exchanges /clearing corporations monitor the positions of the brokers on real time basis. The securities market moved from T+3 settlement period to T+2 rolling settlement with effect from April 1, 2003. Further, straight through processing has been made mandatory for all institutional trades executed on the stock exchange.
- Securities Market Awareness: In January 2003, SEBI launched a nation-wide Securities Market Awareness Campaign that aims at educating investors about the risks associated with the market as well as the rights and obligations of investors.
- Green Shoe Option-As a stabilization tool for post listing price of newly issued shares, SEBI has introduced the green shoe option facility in IPOs.

– Securities Lending and Borrowing- A clearing corporation/clearing house, after registration with SEBI, under the SEBI scheme for Securities Lending and Borrowing, as an approved intermediary, may borrow securities for meeting shortfalls in settlement, on behalf of the members.

– Corporate Governance - To improve the standards of corporate governance, SEBI amended Clause 49 of the Listing Agreement. The major changes in the new Clause 49 include amendments/additions to provisions relating to definition of independent directors, strengthening the responsibilities of audit committees, improving quality of financial disclosures, including those pertaining to related party transactions and proceeds from public/rights/preferential issues, requiring Boards to adopt formal code of conduct, requiring CEO/CFO certification of financial statements and improving disclosures to shareholders. Certain non-mandatory clauses like whistle blower policy and restriction of the term of independent directors have also been included.

– Debt Listing Agreement-In order to further develop the corporate debt market, SEBI prescribed a model debenture listing agreement for all debenture securities issued by an issuer irrespective of the mode of issuance.

– Minimum Public Shareholding-In order to maintain uniformity and also for the purpose of continuous listing, it was decided to amend SEBI (DIP) Guidelines, 2000 providing a minimum public shareholding of 25 per cent in case of all listed companies barring a few exceptions.

– Gold Exchange Traded Funds in India- Based on the recommendations of the Committee, the SEBI (Mutual Funds) Regulations, 1996 were amended and notification was issued on January 12, 2006 permitting mutual funds to introduce GETFs in India subject to certain investment restrictions.

– Guidelines for Issue of Indian Depository Receipts (IDRs) - SEBI issued Guidelines on disclosures and related requirements for companies desirous of issuing IDRs in India. SEBI also prescribed the listing agreement for entities issuing IDRs.

– Mandatory Requirement of PAN for Opening and Operating Demat Accounts-PAN was made mandatory for all demat accounts, opened after April 01, 2006, pertaining to all categories including minors, trusts, foreign corporate bodies, banks, corporates, FIIs, and NRIs. For demat accounts that existed prior to April 01, 2006, time for furnishing and verification of PAN card details was extended upto December 31, 2006.

– Grading of Initial Public offerings (IPOs)-Grading of all IPOs was made mandatory. The grading would be done by credit rating agencies, registered with SEBI. It would be mandatory to obtain grading from at least one credit rating agency. The grading would be disclosed in the prospectus, abridged prospectus and in every advertisement for IPOs.

- Introduction of Fast Track Issuances- To enable compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI introduced fast track issue mechanism. To make the issuance process fast, the earlier requirement of filing draft offer documents was amended and the need to file draft offer documents with SEBI and the stock exchanges was done away with.
- Mandatory Requirement of Permanent Account Number (PAN) for All Transactions in the Securities Market- SEBI stipulated that PAN would be the sole identification number for all participants in the securities market, irrespective of the amount of transaction with effect from July 02, 2007. The objective was to strengthen the 'Know Your Client' (KYC) norms through a single identification number for all participants in the securities market for facilitating sound audit trail.
- Corporate Debt Market- In order to develop a sound corporate debt market in India, SEBI took a number of policy initiatives with respect to the following areas: (i) setting up of reporting platforms for corporate bonds, (ii) setting up of trading platform for corporate bonds, (iii) issues pertaining to trading in corporate bonds, (iv) making amendments to the listing agreement for debentures, (v) issuing securitised debt instruments regulations, (vi) evolving policy guidelines on debenture trustees, (vii) introducing Repos in corporate bonds, (viii) facilitating setting up of quote dissemination platforms, (ix) simplifying corporate bond issuance norms and (x) framing of draft issue and listing regulations for corporate bonds.
- Setting up of SME Exchange-SEBI decided to put in place a framework for setting up of new exchange or separate platform of existing stock exchange having nationwide terminals for SME. In order to operationalise the said framework, necessary changes have been made to applicable regulations, circulars etc. As per the framework, market making has been made mandatory in respect of all scrips listed and traded on SME exchange.
- SEBI made ASBA bid-cum application forms available for download and printing, from websites of the Stock Exchanges which provide electronic interface for ASBA facility i.e. Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). The ASBA forms so downloaded should have a unique application number and can be used for making ASBA applications in public issues.
- Introduction of futures on 91-day Government of India Treasury-Bill (T- Bill) on currency derivatives segment of Stock Exchanges.
- In order to develop the primary market for securitized debt instruments in India, SEBI notified the Securities and Exchange Board of India (Public offer and Listing of Securitised Debt Instruments) Regulations, 2008. The regulations

provide for a framework for issuance and listing of securitized debt instruments by a Special Purpose Distinct Entity (SPDE).

– Investors eligible for discount in public issues permitted to make payment, net of discount, if any, at the time of bidding.
– SEBI has commenced processing of investor grievances against the intermediaries in a centralized web-based complaints redressal system, ‘SCORES’ at http://scores.gov.in/Admin.
– The rating symbols and definitions of CRAs were standardised.
– Guidelines were issued for Qualified Foreign Investors (QFIs) who meet KYC requirement.
– The KYC Registration Agency (KRA) Regulations were notified. The Regulations cover the registration of KRAs, functions and responsibilities of the KRAs and intermediaries, code of conduct, data security, etc.

1.9 The International Organisation of Securities Commissions

The International Organization of Securities Commissions (IOSCO) was created in 1983 with the decision to change from an inter-American regional association (created in 1974) into a global cooperative body. Today IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95% of the world’s securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions and its membership continues to grow. IOSCO provides comprehensive technical assistance to its members, in particular those which regulate emerging securities markets. In 1998 IOSCO adopted a comprehensive set of Objectives and Principles of Securities Regulation (IOSCO Principles), which is recognized as the international regulatory benchmarks for all securities markets.

In 2002 IOSCO adopted a multilateral memorandum of understanding (IOSCO MMoU) designed to facilitate cross-border enforcement and exchange of information among international securities regulators. Then in 2005 IOSCO endorsed the IOSCO MMoU as the benchmark for international cooperation among securities regulators and set-out clear strategic objectives to expand the network of IOSCO MMoU signatories by 2010. It approved as an operational priority the effective implementation - in particular within its membership - of the IOSCO Principles and of the IOSCO MMoU, which are considered primary instruments in facilitating cross-border cooperation, reducing global systemic risk, protecting investors and ensuring fair and efficient securities markets. The Securities and Exchange Board of India is also a signatory to IOSCO MMoU.

There are three Objectives of securities regulation –

– protecting investors;

– ensuring that markets are fair, efficient and transparent;

– reducing systemic risk

The MMoU sets an international benchmark for cross-border co-operation critical to combating violations of securities and derivatives laws. The MMoU represents a common understanding amongst its signatories about how they will consult, cooperate, and exchange information for securities regulatory enforcement purposes. The MMoU itself sets out the specific requirements for what information can be exchanged and how it is to be exchanged: legal ability to compel information; types of information that can be compelled; legal ability to share information; and permissible uses of information. It also sets out specific requirements regarding the confidentiality of the information exchanged, and ensures that no domestic banking secrecy, blocking laws or regulations prevents securities regulators from sharing this information with their counterparts in other jurisdictions.

1.10 Overview of Depository System in India

A depository is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered Depository Participant. India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved. The physical form of securities is extinguished and shares or securities are held in an electronic form. Before the introduction of the depository system through the Depository Act, 1996, the process of sale, purchase and transfer of securities was a huge problem, and there was no safety at all.

Key Feature of the Depository System

1. Multi-Depository System: The depository model adopted in India provides for a competitive multi-depository system. There can be various entities providing depository services. A depository should be a company formed under the Company Act, 1956 and should have been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992. Presently, there are two depositories registered with SEBI, namely:

   – National Securities Depository Limited (NSDL), and

   – Central Depository Service Limited (CDSL)

2. Depository services through depository participants: The depositories can provide their services to investors through their agents called depository participants. These agents are appointed subject to the conditions prescribed under Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and other applicable conditions.

3. Dematerialisation: The model adopted in India provides for dematerialisation of securities. This is a significant step in the direction of achieving a completely paper-free securities market. Dematerialization is a process by which physical certificates of an investor are converted into electronic form and credited to the account of the depository participant.

4. Fungibility: The securities held in dematerialized form do not bear any notable feature like distinctive number, folio number or certificate number. Once shares get dematerialized, they lose their identity in terms of share certificate distinctive numbers and folio numbers. Thus all securities in the same class are identical and interchangeable. For example, all equity shares in the class of fully paid up shares are interchangeable.

5. Registered Owner/ Beneficial Owner: In the depository system, the ownership of securities dematerialized is bifurcated between Registered Owner and Beneficial Owner. According to the Depositories Act, 'Registered Owner' means a depository whose name is entered as such in the register of the issuer. A 'Beneficial Owner' means a person whose name is recorded as such with the depository. Though the securities are registered in the name of the depository actually holding them, the rights, benefits and liabilities in respect of the securities held by the depository remain with the beneficial owner. For the securities dematerialized, NSDL/CDSL is the Registered Owner in the books of the issuer; but ownership rights and liabilities rest with Beneficial Owner. All the rights, duties and liabilities underlying the security are on the beneficial owner of the security.

6. Free Transferability of shares: Transfer of shares held in dematerialized form takes place freely through electronic book-entry system.

1.10 Summary

The Securities Market refers to the markets for those financial instruments/ claims/obligations that are commonly and readily transferable by sale. The Securities Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market. The primary market provides the channel for sale of new securities, while the secondary market deals in securities previously issued. The four main legislations governing the securities market are: the SEBI Act, 1992; the Companies Act, 1956; the Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996. Today IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95% of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved.

1.11 Self Assessment Questions

1. Briefly discuss the evolution, growth and functions of financial system in India.
2. Explain the role of securities market in economic growth.
3. What are the objectives of IOSCO for regulating the Securities Market?
4. Enumerate the key features of depository system in India?

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6. Shashi K Gupta : Financial Institutions and Markets ; Kalyani Publishers, 4863/2B, Bharat Nishja Aggarwal Ram Road, 24, Daryaganj, New Delhi -110002 Neeti Gupta

Unit : 2 - Primary and Secondary Markets

Structure of Unit:

2.0 Objectives

After completing this unit, you would be able to:

- Understand the meaning of new issue market and secondary market;
- Know the functions of new issue market;
- Know the functions of stock exchange;
- Discuss the methods of floating new issue;
- Explain the key players in primary market;

2.1 Introduction

The economic development of a nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. There are areas or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. A Financial System is a composition of various institutions, markets, regulations and laws, practices, money manager, analysts, transactions and claims and liabilities.

An efficient financial system is now regarded as a necessary pre-condition for growth for any country. The responsibility of the financial system is to mobilize the savings in the form of money and monetary assets and invest them to productive ventures. The working of financial system in India can be understood by following diagram.

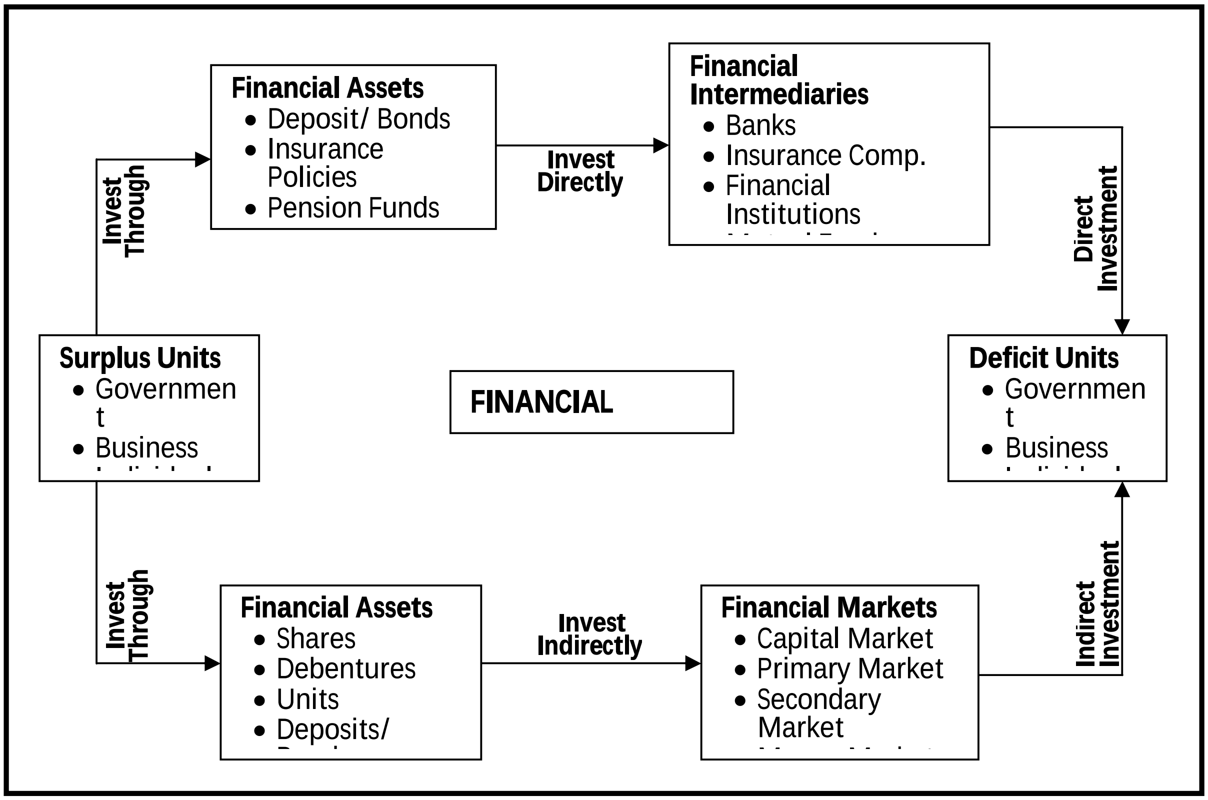


Figure: 2.1 – Working of Financial System

The Indian financial system can also be broadly classified into the formal (organized) financial system and the informal (unorganized) financial system. The formal financial system comes under the purview of the Ministry of Finance (MoF), the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and other regulatory bodies.

The informal financial system consists of:

- Individual moneylenders such as neighbors, relatives, landlords, traders, and storeowners.
- Groups of persons operating as 'funds' or 'associations.' These groups function under a system of their own rules and use names such as 'fixed fund,' 'association,' and 'saving club.'
- Partnership firms consisting of local brokers, pawnbrokers, and non-bank financial intermediaries such as finance, investment, and chit-fund companies.

The various components of Indian financial system are as follows:

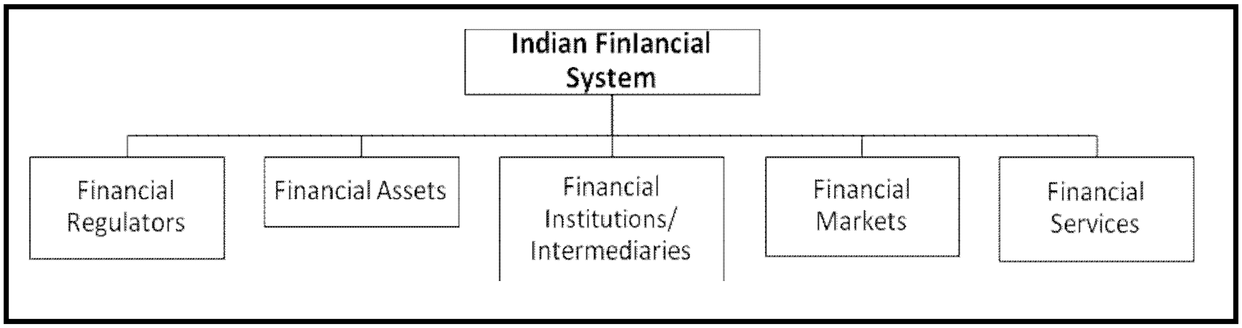
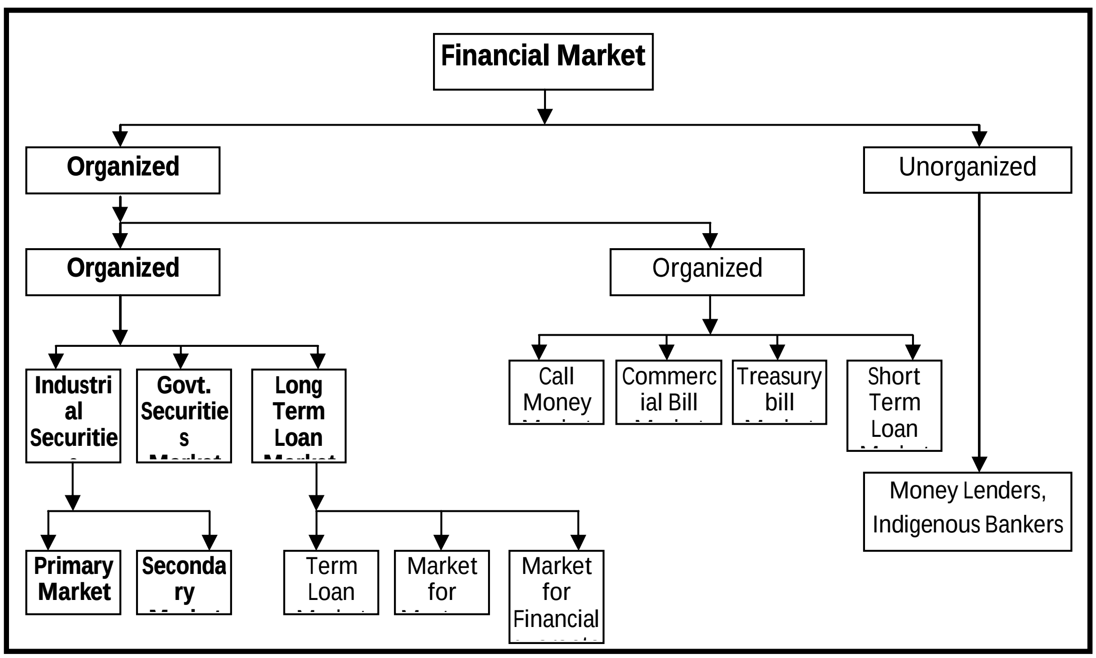


Figure: 2.2 – Classification of Indian Financial System

The present unit of this book is based on a part of capital market, so below a brief discussion is given below about the classification of Indian financial markets.



The financial systems of most developing countries are characterised by coexistence and cooperation between the formal and informal financial sectors. This coexistence of these two sectors is commonly referred to as 'financial dualism.' The formal financial sector is characterised by the presence of an organised, institutional, and regulated system which caters to the financial needs of the modern spheres of economy; the informal financial sector is an unorganised, non-institutional, and non-regulated system dealing with the traditional and rural spheres of the economy.

The informal financial sector has emerged as a result of the intrinsic dualism of economic and social structures in developing countries, and financial repression which inhibits the certain deprived sections of society from accessing funds. The informal system is characterised by flexibility of operations and interface relationships between the creditor and the debtor. The advantages are: low transaction costs, minimal default risk, and transparency of procedures. Due to these advantages, a wide range and higher rates of interest prevail in the informal sector.

An Interpenetration is found between the formal and informal systems in terms of operations, participants, and nature of activities which, in turn, have led to their coexistence. A high priority should be accorded to the development of an efficient formal financial system as it can offer lower intermediation costs and services to a wide base of savers and entrepreneurs.

A Unorganized Markets

The unorganized market consists of money lenders, indigenous bankers, and traders etc. who lend money to the public. Indigenous bankers also collect deposits from the public. There are also private finance companies, chit funds etc., whose activities are not controlled by the RBI. Recently the RBI has taken steps to bring private finance companies and chit funds under its strict control by issuing non-banking financial companies (Reserve Bank) Directions, 1998. The RBI has already taken some steps to bring the unorganized sector under the organized fold. The regulations concerning their financial dealings are still inadequate and their financial instruments have not been standardized.

B Organized Markets

In the organized markets, there are standardized rules and regulations governing their financial dealings. In India, the responsibility for regulating the securities market is shared by the Department of Economic Affairs (DEA), the Ministry of Company Affairs (MCA), the Reserve Bank of India (RBI), and SEBI. The orders of SEBI under the securities laws are appealable before a Securities Appellate Tribunal (SAT).

These organized markets can be further classifies into two. They are:

I. Money Markets

The money market is a component of the financial markets for assets involved in short-term borrowings and lending with original maturities of one year or shorter time frames. Trading in the money markets involves Treasury bills, commercial paper, bankers' acceptances, certificates of deposit, federal funds, and short-lived mortgage- and asset-backed securities. It provides liquidity funding for the global financial system.

II. Capital Market

The securities market has two interdependent and inseparable segments, namely, the new issues (primary) market and the stock (secondary) market. The primary market provides the channel for the creation and sale of new securities, while the secondary market deals in the securities that were issued previously. The securities issued in the primary market are issued by public limited companies or by government agencies. The resources in this kind of market are mobilized either through a public issue or through a private placement route. If anybody can subscribe for the issue, it is a public issue; if the issue is made available only to a select group of people, it is known as private placement. There are two major types of issuers of securities—corporate entities, who issue mainly debt and equity instruments, and the government (central as well as state), which issues debt securities (dated securities and treasury bills).

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risks and returns. Once new securities are issued in the primary market, they are traded in the stock (secondary) market. The secondary market operates through two mediums, namely, the over-the-counter (OTC) market and the exchange-traded market. The OTC markets are informal markets where trades are negotiated. Most of the trades in government securities take place in the OTC market. All the spot trades where securities are traded for immediate delivery and payment occur in the OTC market. The other option is to trade using the infrastructure provided by the stock exchanges. The exchanges in India follow a systematic settlement period. All the trades taking place over a trading cycle (day = T) are settled together after a certain time (T + 2 day). The trades executed on exchanges are cleared and settled by a clearing corporation. The clearing corporation acts as a counterparty and guarantees settlement. A variant of the secondary market is the forward market, where securities are traded for future delivery and payment. A variant of the forward market is the Futures and Options market. Presently, only two exchanges in India—the National Stock Exchange of India Ltd. (NSE) and the Bombay Stock Exchange (BSE)—provide trading in Futures and Options.

The Capital market is a market for financial assets which have a long or indefinite maturity period of above one year. Capital market may be further classified into three namely;

A. Industrial Security Market
B. Government Securities Market
C. Long Term Loans Market

2.2 Primary Market

The primary market enables the government as well corporate in raising the capital that is required to meet their requirements of capital expenditure and/or discharge of other obligations such as exit opportunities for venture capitalist/PE firms. The most common primary mechanism for raising capital is an Initial Public Offer (IPO), under which shares are offered to the public as a forerunner to trading in the secondary market of an exchange. The price at which the shares are to be issued is decided with the help of the book building mechanism; in the case of oversubscription, the shares are allotted on a pro rata basis. When securities are offered exclusively to the existing shareholders of company, as opposed to the general public, it is known as Rights Issue. Another mechanism whereby a listed company can issue equity shares, as well as fully and partly convertible debentures that can be later converted into equity shares, to a Qualified Institutional Buyer (QIB) is termed as Qualified Institutional Placement. In addition to raising capital in the domestic market, companies can also issue securities in the international market through the ADR/GDR/ECB route to raise capital.

Primary market transactions involve the initial sale of securities, when stocks and bonds are first sold to the public. This is also when the interaction between borrowers (issuers) and lenders (investors) takes place i.e. when firms acquire new capital from lenders by issuing new stocks and/or bonds. Thus it deals with the new securities which were not previously available to the investing public.

Examples of primary vs. secondary market transactions:

i) "Nike" issues a new round of stock and Mr. Dhruv buys 10 shares. This is a primary market transaction. Nike acquires new funds from Dhruv and he acquires new shares

ii) Mr. Dhruv decides to sell the Nike shares to a mutual fund. This is a secondary market transaction. Mr. Dhruv acquires funds from the mutual fund and the fund acquires the shares. Nike (the issuer) gets NOTHING in this transaction. It is simply money changing hands from one investor to another.

iii) The U.S. government issues 10 year Treasury Notes to finance the deficit. "Calpers", a large institutional investor, buy a portion of this new issue. This is a primary market transaction. U.S. government acquires new funds from Calpers, and Calpers acquires new bonds

iv) Calpers then sell these bonds on the market to Vanguard, a mutual fund company. This is a secondary market transaction. Calpers acquires Vanguard's money, Vanguard gets the bonds. The U.S. government (the issuer) receives NOTHING from this transaction.

2.2.1 Features of Primary Market

Features of primary markets are:

- This is the market for new long term equity capital. The primary market is the market where the securities are sold for the first time. Therefore it is also called the new issue market (NIM).
- In a primary issue, the securities are issued by the company directly to investors.
- The company receives the money and issues new security certificates to the investors.
- Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.

- The primary market performs the crucial function of facilitating capital formation in the economy.
- The new issue market does not include certain other sources of new long term external finance, such as loans from financial institutions. Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as "going public."

2.2.2 Regulatory Framework for the Primary Market

The regulatory framework for primary markets in Indian comprises of the SEBI Act, 1992. SEBI regulations and rules for various intermediaries, for the issue of capital by management tie up with certain provisions of the companies Act, 1956. The following are the important enactments relating to the primary market in India (Table1.1):

Table1.1 - Enactments Relating to the Indian Primary Market

Serial	**Details**
a	SEBI (Disclosure and Investor Protection) Guidelines, 2000
b	SEBI (Merchant Bankers) Rules and Regulations, 1992
c	SEBI (Banker to the Issue) Rules and Regulations, 1994
d	SEBI (Registrar to an Issue) Rules and Regulations, 1993
e	SEBI (Underwriters) Rules and Regulations, 1993

2.2.3 Functions of New Issue Market

The main function of a new issue market is to facilitate transfer of resources from savers to the users. The savers are individuals, commercial banks, insurance companies etc. The users are public limited companies and the government. The new issue market plays an important role of mobilizing the funds from the savers and transforming them to borrowers for productive purposes, an important requisite of economic growth. It is not only a platform for raising finance to establish new enterprises but also for expansion/ diversification/ modernizations of existing units. On this basis the new issue market can be classified as:

1. Market where firms go to the public for the first time through initial public offering (IPO).
2. Market where firms which are already trading raise additional capital through seasoned equity offering (SEO). An issue of additional securities from an established company whose securities already trade in the secondary market. A seasoned issue is also known as a "seasoned equity offering" or "follow-on offering." New shares issued by blue-chip companies are considered seasoned

issues. Outstanding bonds trading in secondary markets are also called seasoned issues.

3. Market where an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document through further public offering (FPO)

The main function of a new issue market can be divided into a triple service functions:

1. **Origination**

   Origination refers to the work of investigation, analysis and processing of new project proposals. Origination starts before an issue is actually floated in the market. There are two aspects in this function:

   (i) A carefully study of the technical, economic and financial viability to ensure soundness of the project. This is a preliminary investigation undertaken by the sponsors of the issue.

   (ii) Advisory services which improve the quality of capital issues and ensure its success.

   The advisory services include:

   a. Type of issue- This refers to the kind of securities to be whether equity share, preference share, debenture or convertible debenture.
   b. Magnitude of issue
   c. Time of floating an issue
   d. Pricing of an issue – whether shares are to be issued at par or at premium
   e. Methods of issue
   f. Technique of selling the securities

   The function of origination is done by merchant bankers who may be commercial banks, all India financial institutions or private firms. The origination itself does not guarantee the success of the issue. Underwriting; a specialized service is required in this regard.

2. **Underwriting**

   Underwriting is an agreement whereby the underwriter promises to subscribe to a specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue. If the issue is fully subscribed, then there no liability for the underwriter. If a part of share issues remains unsold, the underwriter will buy the shares. Thus, underwriting is a guarantee for the marketability of shares.

Methods of Underwriting: - An underwriting agreement may take any of the following three forms:

(i) ***Standing behind the Issue-*** Under this method, the underwriter guarantees the sale of a specified number of shares within a specified period. If the public do not subscribe to the specified amount of issue, the underwriter buys the balance in the issue.

(ii) ***Outright Purchase-*** The underwriter, in this method, makes outright purchase of shares and resells them to the investors.

(iii) ***Consortium Method-*** In this method, Underwriting is jointly done by a group of underwriters. The underwriters form a syndicate for this purpose. This method is adopted for large issues.

Advantages of Underwriting: - Underwriting assumes great significance as it offers the following advantages to the issuing company

(i) The issuing company is relived from the risk of finding buyers for the issue offered to the public. The company is assured of raising adequate capital.

(ii) The company is assured of getting the minimum subscription within the stipulated time, a statutory obligation to be fulfilled by the issuing company.

(iii) Underwriters undertake the burden of highly specialized function of distributing securities.

(iv) They provide expert advice with regard to timing of security issue, the pricing of issue, the size and type of securities to be issued etc.

(v) Public confidence on the issue is enhances when underwritten is done by reputed underwriters.

The underwriters in India may be classified into two categories:

a) Institutional underwriters

b) Non-institutional underwriters

(a) The institutional underwriters are (a) LIC (b) UTI (c) IDBI (d) ICICI, (e) Commercial Banks and General Insurance Companies. The pattern of underwriting of the above institutional underwriters differs vastly in India. LIC and UTI purchase industrial securities from the new issue market with a view to holding them on their own portfolio. They have a preference for underwriting shares in large and well established firms. The development banks have given special attention to the issues in backward states and industries in the priority list. The thrust of the development banks is also towards small and new issues which do not have adequate support from other institutions. General Insurance companies show preference in underwriting the securities of fairly new issues.

(b) The non-institutional underwriters are brokers. They guarantee shares only with a view to earning commission from the company floating the issue. They are known to off-load the shares later t make a profit. The brokers work with profit motive in underwriting industrial securities.

3. **Distribution**

   Distribution is the function of selling of securities to ultimate investors. This service is performed by brokers and agents who maintain a regular and direct contact with the ultimate investors.

2.2.4 Methods of Floating New Issues

The various methods which are used in the flotation of securities in the new issue market are:

1. Public issues
2. Offer for sale
3. Placement
4. Rights issues
5. ESOP

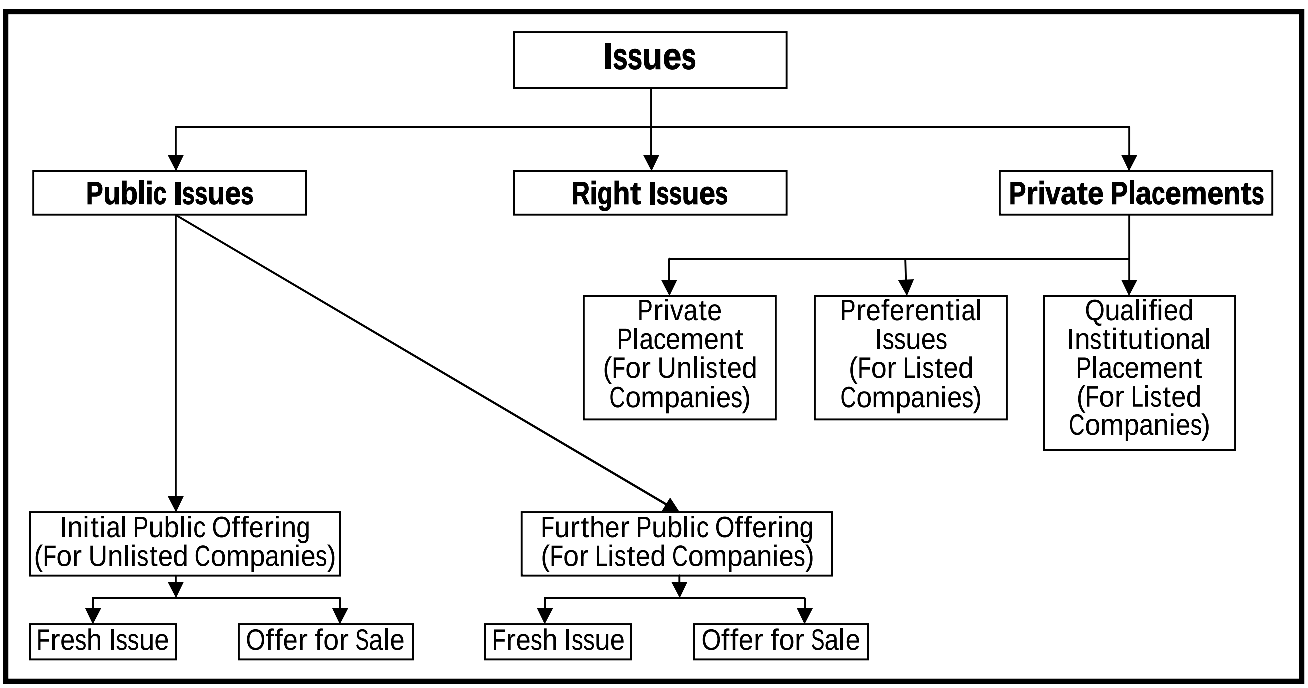


Figure1.4: Types of issues

1. Public Issues

Under this method, this issuing company directly offers to the general public/ institutions a fixed number of shares at a stated price through a document called prospectus. This is the most common method followed by joint stock companies to raise capital through the issue of securities.

The prospectus must state the following:

(i) Name of the company

(ii) Address of the registered office

(iii) Existing and proposed activities

(iv) Location of the industry

(v) Names of Directors

(vi) Authorized and proposed issue capital to the public

(vii) Date of opening and closing the subscription list

(viii) Minimum subscription

(ix) Names of brokers/ underwriters/ bankers/ managers and registrars to the issue.

(x) A statement by the company that it will apply to stock exchange for quotations of its shares.

Public issues can be further classified into Initial Public offerings and further public offerings. In a public offering, the issuer makes an offer for new investors to enter its shareholding family. The issuer company makes detailed disclosures as per the Disclosure and Investor Protection (DIP) guidelines issued by SEBI in its offer document and offers it for subscription. The significant features are illustrated below:

Initial Public Offering (IPO) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.

A Further public offering (FPO) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document. An offer for sale in such scenario is allowed only if it is made to satisfy listing or continuous listing obligations.

According to Companies Act, 1956 every application form must be accompanied by a prospectus. Now, it is no longer necessary to furnish a copy of the prospectus along with every application form as per the Companies Act, 1988. Now, an abridged prospectus is being annexed in every share application form.

Merits of Issue through Prospectus

(i) Sale through prospectus has the advantage of inviting a large section of the investing public through advertisement.

(ii) It is a direct method and no intermediaries are involved in it.

(iii) Shares, under this method, are allotted to a large number of investors on a non-discriminatory basis. This procedure helps in wide dispersion of shares and to avoid concentration of wealth in few hands.

Demerits

(i) It is an expensive method. The company has to incur expenses on printing of prospectus, advertising, bank's commission, underwriting commission. Legal charges, stamp duty, listing fee and registration charges.

(ii) This method is suitable only for large issues.

2. Offer for Sale

This method of offer of sale consists in outright sale of securities through the intermediary of Issue Houses or share-brokers. In other words, the shares are not offered to the public directly. This method consists of two stages: The first stage is a direct sale by the issuing company to the issue house and brokers at an agreed price. In the second stage, the intermediaries resell the above securities to the ultimate investors. The issue houses or stock brokers purchase the securities at a negotiated price and resell at a higher price. The difference in the purchase and sale price is called spread. It is otherwise called Bought out deals (BOD).

This method is used generally in two instances:

(i) Offer by a foreign company of a part of it to Indian investors.

(ii) Promoters diluting their stake to comply with requirements of Stock exchange at the time of listing of shares.

3. Placement

Under this method, the issue houses or brokers buy the securities outright with the intention of placing them with their clients afterwards. Here the brokers act as almost wholesalers selling them in retail to the public. The brokers would make profit in the process of reselling to the public. The issue houses or brokers maintain their own list of clients and through customer contact sell the securities. There is no need for a formal prospectus as well as underwriting agreement.

In other words a private placement is an issue of shares or of convertible securities by a company to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital.A private placement of shares or of convertible securities by a listed company is generally known by name of preferential allotment. A listed company going for preferential allotment has to comply with the requirements contained in Chapter XIII of SEBI (DIP) Guidelines pertaining to preferential allotment in SEBI (DIP) guidelines which interalia include pricing, disclosures in notice etc, in addition to the requirements specified in the Companies Act.

A Qualified Institutions Placement is a private placement of equity shares or securities convertible in to equity shares by a listed company to Qualified Institutions Buyers only in terms of provisions of Chapter XIIIA of SEBI (DIP) guidelines. The Chapter contains provisions relating to pricing, disclosures, currency of instruments etc.

4. Rights Issue

It is a method of raising funds in the market by an existing company. A right means an option to buy certain securities at a certain privileged price within a certain specified period. Shares, so offered to the existing shareholders are called rights shares. Rights shares are offered to the existing shareholders in a particular proportion to their existing share ownership. The ratio in which the new shares or debentures are offered to the existing share capital would depend upon the requirement of capital. The rights themselves are transferable and sale-able in the market. Section 81, of the Companies Act deals with rights issue.

Advantages

(i) The cost of issue is minimum. There is no underwriting, brokerage, advertising and printing of prospectus expenses.

(ii) It prevents the directors from issuing new shares in their own name or to their relatives at a lower price and get controlling right.

5. Employee Stock Ownership Plan (ESOP)

An employee stock ownership plan (ESOP) is an employee-owner method that provides a company's workforce with an ownership interest in the company. In an ESOP, companies provide their employees with stock ownership, often at no up-front cost to the employees. ESOP shares, however, are part of employees' remuneration for work performed. Shares are allocated to employees and may be held in an ESOP trust until the employee retires or leaves the company. The shares are then sold.

ESOPs have several features which make them unique compared to other employee benefit plans. Most companies, both at home and abroad, are utilizing this scheme as an essential tool to reward and retain their employees. Currently, this form of restructuring is most prevalent in IT companies where manpower is the main asset.

In the overseas context, ESOP (where the 'O' often stands for ownership) is seen when employees buy over the stock of an owner or promoter who is relinquishing charge. In India, ESOP is used largely to motivate employees to put in their best and in turn, help the company enjoy lower employee turnover and retain its talent pool. These two uses probably account for over two-thirds of all ESOPs now in existence, and their numbers are expected to increase with time.

Interestingly, many companies abroad use ESOPs as a technique of corporate finance for a variety of purposes -- to finance expansion, to make an acquisition, to spin off a division, to take a company private, and so on. This has yet to catch on in India, perhaps because the scale of ESOP so far is too small for many of these uses.

So far as the future of ESOPs in India is concerned, as more and more companies realize the need to retain their best talent in a world which would be dominated by companies with the best intellectual capital, this management technique would be the phenomenon of the new century.

2.2.5 General Guidelines for New Issues

The primary market is governed by the provisions of the Companies Act, 1956, which deals with issues, listing, and allotment of securities. Additionally, SEBI prescribes the eligibility and disclosure norms through the ICDR Regulations 2009 that the issuer and the promoter need to comply with for accessing the market. In this section, we discuss the market design related to public issues, offer for sale, and rights issue by listed and unlisted companies, as per the ICDR Regulations prescribed by SEBI.

Eligibility Norms:

Any company issuing securities has to satisfy the following conditions at the time of filing the draft offer document and the final offer document with SEBI and the Registrar of Companies/designated stock exchanges:

- File a draft offer document with SEBI, along with the specified fees through an eligible merchant banker, at least 30 days prior to the filing of the red herring prospectus or shelf prospectus with the Registrar of Companies (RoCs) or the filing of the letter of offer with the designated stock exchanges, as the case may be.
- Obtain In-principle approval from all the recognized stock exchanges in which the issuer proposes to get its specified securities listed.
- Enter into an agreement with the depository for the dematerialization of its securities that are already issued or are proposed to be issued.

A company can make an IPO as per the following conditions:

- It has net tangible assets of at least ` 3 crore in each of the preceding three full years, of which not more than 50 percent is held in monetary assets, provided that if more than 50 percent of the net tangible assets are held in monetary assets, the company has made firm commitments to deploy such excess monetary assets in its business/project. In the case of a pure Offer for Sale, the requirement that not more than 50 percent of the net tangible assets shall be held as monetary assets shall not be applicable;
- It has a net worth of at least ` 1 crore in each of the preceding three full years;

- It has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least three of the immediately preceding five years, provided further that extraordinary item shall not be considered for calculating distributable profits in terms of Section 205 of Companies Act, 1956. The requirement of track record of distributable profits for at least three out of immediately preceding five years shall be complied with on both a stand-alone as well as a consolidated basis;
- The aggregate of the proposed issue and all previous issues made in the same financial year in terms of size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year; and

In case the company has changed its name within the last one year, at least 50 percent of the revenue for the preceding one full year is earned by the company from the activity suggested by the new name.

In case these conditions are not satisfied, an issuer can still make an IPO on complying with the following guidelines:

1. The issue should be made through the book building process with at least 50 percent of net offer to public being allotted to the QIBs; if not, then the full subscription monies has to be refunded, OR The project should have at least 15 percent of the cost of project contributed by public financial institutions or scheduled commercial banks, of which at least 10 percent should come from the appraiser. In addition, at least 10 percent of the issue size should be allotted to QIBs; otherwise, the full subscription monies should be refunded; AND
2. Minimum post-issue face value capital of the company should be ` 10 crore, OR There should be compulsory market making for at least two years from the date of listing of securities, subject to certain conditions as specified in the regulations. A company can make an IPO of convertible debt instruments without making a prior public issue of its equity shares, and can list the same. Pursuant to a public issue, no allotment can be made if the number of prospective allottees is less than one thousand. The issuer will not make an IPO if there are any outstanding convertible securities or any other rights that would entitle any person with any option to receive equity shares.

Credit Rating for Debt Instruments:

No public issue or rights issue of convertible debt instruments can be made unless a credit rating of not less than investment grade is obtained from at least one credit rating agency registered with SEBI. In case the credit rating is obtained from more than one credit rating agency, all the credit rating/s, including the unaccepted credit ratings, should be disclosed. All the credit ratings obtained in the three years preceding the public or rights issue of debt instruments (including convertible instruments) for any listed security of the issuer company should be disclosed in the offer document.

IPO Grading:

No issuer should make an IPO of equity shares or any other securities that may be converted into or exchanged with equity shares at a later date, unless the following conditions are satisfied as on the date of filing of the Prospectus (in the case of fixed price issues) or the Red Herring Prospectus (in the case of book built issues) with the RoC:

- The issuer has obtained a grading for the IPO from at least one credit rating agency.
- Disclosures of all the grades obtained along with the rationale/description furnished by the credit rating agency/agencies for each of the grades obtained, have been made in the Prospectus (in the case of fixed price issues) or the Red Herring Prospectus (in the case of book built issues).
- The expenses incurred for grading the IPO have been borne by the unlisted company obtaining the grading for the IPO.

Every company obtaining a grading for its IPO should disclose the grades obtained—along with the rationale/description furnished by the credit rating agency/agencies for each of the grades obtained—in the prospectus, abridged prospectus, issue advertisements, and in all the other places where the issuer company is advertising the IPO.

Pricing of Public Issues:

An issuer may determine the price of specified securities, coupon rate, and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process. An issuer making an IPO may determine the face value of equity shares subject to the provisions of the Companies Act, 1956, the SEBI Act and Regulations. If the issue price per equity share is ` 500 or more, the issuer shall have the option of determining the face value at less than ` 10 per equity share, subject to the condition that the face value shall not be less than ` 1 per equity share. In case the issue price per equity share is less than ` 500 per equity share, the face value of the shares shall be ` 10 per equity share. The previous clause does not apply to IPOs made by any government company, statutory authority or corporation, or any special purpose vehicle set up by any of them that is engaged in the infrastructure sector.

The disclosure of the face value of equity shares (including the statement about the issue price being x times the face value) shall be made in the advertisements, offer documents, and application forms.

Differential Pricing:

An issuer may offer equity shares and convertible securities at different prices, subject to the following conditions:

(a) The retail individual investors/shareholders or employees entitled for reservation making an application for equity shares and convertible securities of value not more than ` 2 lakh may be offered equity shares and convertible securities at a price lower than the price at which the net offer is made to other categories of applicants, provided that such difference is not more than 10 percent of the price at which the equity shares and convertible securities are offered to other categories of applicants.

(b) In the case of a book built issue, the price of the equity shares and convertible securities offered to an anchor investor cannot be lower than the price offered to other applicants.

(c) In the case of a composite issue, the price of the equity shares and convertible securities offered in the public issue may be different from the price offered in the rights issue, and the justification for this price difference should be given in the offer document.

(d) In case the issuer opts for the alternate method of book building, the issuer may offer specified securities to its employees at a price lower than the floor price. However, the difference between the floor price and the price at which the equity shares and convertible securities are offered to the employees should not be more than 10 percent of the floor price.

Price and Price Band:

The issuer can mention the price or price band in the draft Prospectus (in the case of a fixed price issue) and the floor price or price band in the Red Herring Prospectus (in the case of a book built issue) and determine the price at a later date before registering the Prospectus with the Registrar of Companies, which would need to contain only one price or the specific coupon rate, as the case may be. If the floor price or price band is not mentioned in the Red Herring Prospectus, the issuer shall announce the floor price or price band at least two working days before the opening of the bid in the case of an IPO, and at least one working day before the opening of the bid in the case of an FPO. The cap on the price band shall be less than or equal to 120 percent of the floor price. The floor price or the final price shall not be less than the face value of the specified securities. The 'cap on the price band' includes the cap on the coupon rate in the case of convertible debt instruments.

Contribution of Promoters and Lock-in:

- The promoters' contribution in the case of an IPO should not be less than 20 percent of the post-issue capital.
- In the case of a further public offer, the promoters should contribute up to 20 percent of the proposed issue, or should ensure a post-issue share holding that is up to 20 percent of the post-issue capital.
- For a composite issue, the promoters' contribution should be either 20 percent of the proposed issue size or 20 percent of the post-issue capital.

- At least one day prior to the opening of the issue, the promoters should bring in the full amount of the promoters' contribution, including the premium, which should be kept in an escrow account with a Scheduled Commercial Bank, and the said contribution/amount should be released to the company along with the public issue proceed.
- The minimum promoters' contribution should be locked in for a period of three years in the case of public issues. However, if the promoters' contribution exceeds the required minimum, then the excess is locked in for a period of one year.
- The lock-in period starts from the date of commencement of commercial production (the last date of the month in which commercial production in a manufacturing company is expected to commence, as stated in the offer document) or the date of allotment in the public issue, whichever is later.
- The entire pre-issue share capital, other than that of the promoters, shall be locked for a period of one year. The securities allotted on a firm allotment basis are also locked in for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later. The locked-in securities held by the promoters may be pledged only with banks or public FIs as collateral security for loans granted by such banks or FIs.

Pre-Issue Obligations:

The lead merchant banker has to exercise due diligence and satisfy himself/herself about all aspects of the issue including the offering, veracity, and adequacy of disclosures in the offer document. The liability of the merchant banker will continue even after the completion of the issue process. The lead merchant banker has to pay the requisite fee in accordance with Regulation 24A of the Securities and Exchange Board of India (Merchants Bankers) Rules and Regulations, 1992, along with the draft offer document filed with the Board. In the case of a fast track issue, the requisite fee shall be paid along with the copy of the Red Herring Prospectus, Prospectus, or letter of offer, as the case may be. Each company issuing securities through public or rights issue has to enter into a Memorandum of Understanding (MOU) with the lead merchant banker, which specifies their mutual rights, liabilities, and obligations.

- The lead merchant banker responsible for drafting the offer documents has to submit to the Board the copy of the MOU entered into with the issuer company and the draft of the offer document.
- In case a public or rights issue is managed by more than one merchant banker, the rights, obligations, and responsibilities of each merchant banker should be demarcated as specified in Schedule I.
- In the case of under-subscription of an issue, the lead merchant banker responsible for the underwriting arrangements should invoke the underwriting obligations, and ensure that the notice for devolvement containing the obligations of the underwriters is issued in terms of the regulations as specified in Schedule I.

- The lead merchant banker should furnish to the Board a due diligence certificate as specified in Schedule IV, along with the draft offer document.
- In the case of a fast track issue of convertible debt instruments, the lead merchant banker should furnish a due diligence certificate to the Board as per the format specified in Schedule VI. The lead merchant bankers should satisfy themselves about the ability of the underwriters to discharge their underwriting obligations. With respect to every underwritten issue, the lead merchant banker(s) should undertake a minimum underwriting obligation of 5 percent to the total underwriting commitment of ` 25 lakh. The outstanding underwriting commitments of a merchant banker should not exceed 20 times its net worth at any point of time.

Regarding an underwritten issue, the lead merchant banker should ensure that the relevant details of the underwriters are included in the offer document. The draft offer documents filed with the Board should be made public for a period of 21 days from the date of filing the offer document with the Board, and should be filed with the stock exchanges where the securities are proposed to be listed. Further, the draft offer documents should be put up on the Websites of the lead managers/syndicate members associated with the issue, and it should also be ensured that the contents of the documents hosted on the Websites are the same as those of their printed versions.

Twenty-one days after the draft offer document has been made public, the lead merchant banker should file a statement with the Board giving a list of complaints received, and a statement as to whether it is proposed to amend the draft offer document or not, highlighting those amendments. The lead manager should also ensure that the issuer company has entered into agreements with all the depositories for the dematerialization of the securities. An issuer company has to appoint a compliance officer who will directly liaise between the Board and the issuer company with regard to compliance with the various laws, rules, regulations, and other directives issued by the Board

Post-Issue Obligations:

Subsequent to the issue, the lead merchant banker should ensure that the post-issue monitoring reports are submitted, irrespective of the level of subscription. Additionally, the merchant banker should be associated with the allotment, refund, and dispatch, and should also monitor the redressing of investor grievances arising from them. The lead merchant banker should ensure that the dispatch of the share certificates/refund orders and demat credit is completed, and that the allotment and listing documents are submitted to the stock exchanges within two working days following the date of allotment.

Credit Rating:

Credit rating agencies (CRA) can be promoted by public financial institutions, scheduled commercial banks, foreign banks operating in India, or by any corporate body having a continuous minimum net worth of ` 100 crore for the previous five years. Further, foreign credit rating agencies recognized by or under any law in force at the moment in the country of its incorporation, having at least five years' experience in rating securities can also operate in the country. The SEBI (Credit Rating Agencies) Regulations, 1999 cover the rating of the securities listed, and not fixed deposits, foreign exchange, country ratings, and real estate. No company can make a public issue or rights issue of debt instruments (whether convertible or not), unless credit rating is obtained from at least one CRA registered with the Board and this disclosed in the offer document. Where ratings are obtained from more than one CRA, all the ratings including the unaccepted ratings should be disclosed in the offer document.

Merchant Banking:

The merchant banking activity in India is governed by the SEBI (Merchant Bankers) Regulations, 1992. Consequently, all the merchant bankers have to be registered with SEBI. The details about them are presented below:

Category I- To carry on activity of the issue management, to act as adviser, consultant, manager, underwriter, portfolio manager

Category II -To act as adviser, consultant, co-manager, underwriter, portfolio manager

Category III -To act as underwriter, adviser, consultant to an issue

Category IV- To act only as adviser or consultant to an issue.

Only a corporate body other than a non-banking financial company having the necessary infrastructure, with at least two experienced employees can apply for registration as a merchant banker. The capital adequacy requirement should be a net worth of ` 50 million. The regulations cover the code of conduct to be followed by merchant bankers, the responsibilities of the lead managers, the payments of fees, and the disclosures to SEBI.

Demat Issues:

SEBI has mandated that all new IPOs should be compulsorily traded in a dematerialized form only. Further, Section 68B of the Companies Act, 1956 requires that every listed public company making an IPO of any security for ` 10 crore or more should issue the same only in dematerialized form. The investors, however, would have the option of subscribing to securities in either physical or dematerialized form.

Private Placement:

Private placement involves the issue of securities, debt, or equity to selected subscribers, such as banks, FIs, MFs, and high net worth individuals. It is arranged through a merchant/investment banker, who acts as an agent of the issuer and brings together the issuer and the investor(s). Since these securities are allotted to a few sophisticated and experienced investors, the stringent public disclosure regulations and registration requirements are relaxed. The Companies Act, 1956, states that an offer of securities to more than 50 persons is deemed to be a public issue.

2.2.6 Principal Steps in Private Placement

It may be done in respect of equity shares, preference shares, bonds and debentures. Generally, the private placement of bonds and debentures is very popular.

The following steps are involved -

1. **Terms and conditions**: They include the value of the instrument, maturity period, yield rate, issue and redemption details, etc.
2. **Credit rating**: It is mandatory to obtain credit rating from a recognized credit rating agency who will evaluate the various aspects concerned with the instrument.
3. **Confidential Information Memorandum (CIM)**: It is just like the offer document in the case of shares. An investor can have a thorough knowledge about the issue by going through this document.
4. **Trustees to the issue**: The next step is to appoint trustees (usually banks or other financial institutions) to the issue to protect the interest of investors.
5. **Pre-launching formalities** : Just one or two days before the launching date, the CIM is sent to the prospective investors inviting them to subscribe to the issue.
6. **Pricing the issue**: Sometimes pre-marketing campaign may be conducted by the issue houses to ascertain the investors towards private placement and the probable prices. Since book building method is adopted by many companies, this campaign is not generally resorted to.
7. **Post-issue Steps**: Decision is taken on allotment and the certificates are issued. Over subscriptions are refunded. The details of the issue are sent to the stock exchange where it is likely to be listed.

2.2.7 Principal Steps Involved in the case of Offer for Sale

1. **Agreement with the merchant banker** or sponsor group laying down the terms and conditions of the issue.
2. **Registration of the agreement** with the stock exchange concerned.
3. **Default** - It is default is committed by the sponsor; it will be referred to an arbitrage committee set up by the stock exchange.
4. **Offloading** - Sponsor can offload his position provided the promoter's post-issue holding will not be less than 20% with a 3 year lock in period.
5. **Market Maker** - The sponsor should agree to act as a market maker for the company’s share for 18 months and should also identify another market maker for such compulsory market making. These two market makers should hold upto 5 percent of the equity offered to the public themselves.

2.2.8 Qualified Institutional Buyer (QIBs), Non-institutional buyers (NIBs) and high net worth individuals (HNIs)

Qualified Institutional Buyers are those institutional investors who are generally perceived to possess expertise and the financial muscle to evaluate and invest in the capital markets. In terms of clause 2.2.2B (v) of DIP Guidelines, a 'Qualified Institutional Buyer' shall mean:

a. Public financial institution as defined in section 4A of the Companies Act, 1956;
b. Scheduled commercial banks;
c. Mutual funds;
d. Foreign institutional investor registered with SEBI;
e. Multilateral and bilateral development financial institutions;
f. Venture capital funds registered with SEBI.
g. Foreign Venture capital investors registered with SEBI.
h. State Industrial Development Corporations.
i. Insurance Companies registered with the Insurance Regulatory and Development Authority (IRDA).
j. Provident Funds with minimum corpus of Rs.25 crores
k. Pension Funds with minimum corpus of Rs. 25 crores)

These entities are not required to be registered with SEBI as QIBs. Any entities falling under the categories specified above are considered as QIBs for the purpose of participating in primary issuance process.

Investors who are individual or companies, but do not fall in the category of either QIBs or Retail Individual Investors (RIIs), are classified as NIBs or HNIs.

2.2.9 ASBA Route to applying for IPOs

The SEBI has introduced a new facility viz. Application supported by Block Amount (ASBA) route to applying for IPOs from Sept. 2008 onwards. The ASBA allows subscribers to public issues to have their application money blocked in a special account in a bank so that they have to pay only upon allotment of shares. The banks offering ASBA are called self certified syndicate banks (SCSB). It is a good way for banks to mobilize deposits and at the same time it is a simple, smart and safe way of making an application. But the response to this new route from the retail investors seems to be poor. This facility is available to Qualified Institutional Buyers and also to High Net worth Individuals. It is expended to Rights issue also.

2.2.10 French Auction Method

The Government has decided to adopt French auction method for public offers from the existing Dutch auction method in many ways. Under the Dutch auction method, investors have to bid within the price band fixed by the issuing company. Finally shares would be allotted proportionately at uniform price to the allottees. But, under French auction route, there will be no upper limit to bid price and the highest bidder will secure the largest share of allotments. In other words, the highest bidders, in the descending order, will get preference in allotment based on the price bids they have placed for the shares. This is an alternative book building model. A complete freedom is given to lid above a certain floor price and allotment takes place on price – priority basis and that too at differential prices. The basic principal involved is higher the bid, Higher the allocation. This method has a district advantage of better price discovery through keen competition among investors. It is being tried for the institutional portion of the issue.

2.3 Secondary Market

The secondary market is where securities are traded after being initially offered to the public in the primary market and/or being listed on the stock exchange. The stock exchanges along with a host of other intermediaries provide the necessary platform for trading in the secondary market, and also for clearing and settlement. The securities are traded, cleared, and settled within the regulatory framework prescribed by the exchanges and the SEBI. The exchanges (NSE/BSE) have laid down rules and guidelines for various intermediaries with regard to the admission and the fee structure for trading members, listing criteria, and the listing fees for companies. With the increased application of information technology, the trading platforms of the stock exchanges are accessible from anywhere in the country through their trading terminals. The trading platforms are also accessible through the Internet. In a geographically widespread country like India, this has significantly expanded the reach of the exchanges. The secondary market is composed of equity markets and the debt markets.

2.3.1 Functions of Stock Exchange

(i) **Maintains Active Trading:** Shares are traded on the stock exchanges, enabling the investors to buy and sell securities. The prices may vary from transaction to transaction. A continuous trading increases the liquidity or marketability of the shares traded on the stock exchanges.

(ii) **Fixation of Prices:** Price is determined by the transactions that flow from investors' demand and supplier's preferences. Usually the traded prices are made known to the public. This helps the investors to make better decisions.

(iii) **Ensures Safe and Fair Dealing:** The rules, regulations and by-laws of the stock exchanges' provide a measure of safety to the investors. Transactions are conducted under competitive conditions enabling the investors to get a fair deal.

(iv) **Aids in Financing the Industry:** A continuous market for shares provides a favorable climate for raising capital. The negotiability and transferability of the securities helps the companies to raise long-term funds. When it is easy to trade the securities, investors are willing to subscribe to the initial public offerings. This stimulates the capital formation.

(v) **Dissemination of Information:** Stock exchanges provide information through their various publications. They publish the share prices traded on daily basis along with the volume traded. Directory of Corporate information is useful for the investors' assessment regarding the corporate. Handouts, handbooks and pamphlets provide information regarding the functioning of the stock exchanges.

(vi) **Performance Inducer:** The prices of stock reflect the performance of the traded companies. This makes the corporate more concerned with its public image and tries to maintain good performance.

(vii) Self-regulating Organization: The stock exchanges monitor the integrity of the members, brokers, listed companies and clients. Continuous internal audit safeguards the investors against unfair trade practices. It settles the disputes between member brokers, investors and brokers.

(viii) Liquidity and Marketability of Securities: Stock exchanges provide liquidity to securities since securities can be converted into cash at any time according to the discretion of the investor by selling then at the listed prices. They facilitate buying and selling of securities at listed process by providing continuous marketability to the investors in respect of securities they hold or intend to hold. Thus, they create a ready outlet for dealing in securities.

(ix) Reflection of Business Cycle: The changing business conditions in the economy are immediately reflected in the stock exchanges. Booms and depressions can identified through the dealings on the stock exchanges and suitable monetary and fiscal policies can be taken by the government. Thus a stock market portrays the prevailing economic situation instantly to all concerned so that suitable actions can be taken.

2.3.2 Regulatory Framework

A comprehensive legal framework was provided by the Securities Contract Regulation Act, 1956 and the Securities and Exchanges Board of India Act, 1992. A three tire regulatory structure comprising the Ministry of Finance, the Securities and Exchanges Board of India and the Governing Boards of the Stock Exchanges regulates the functioning of stock exchanges.

✓ **Ministry of Finance**

The stock Exchanges Division of the Ministry of Finance has powers related to the application of the provision of the SCR Act and licensing of dealers in the other area. According to SEBI Act, the Ministry of Finance has the appellate and supervisory powers over the SEBI. It has power to grant recognition to the stock Exchanges and regulation of their operations. Ministry of Finance has the power to approve the appointments of executive chiefs and nominations of the public representatives in the Governing Boards of the stock exchanges. It has the responsibility of preventing undesirable speculation.

The Securities and Exchange Board of India even though established in the year 1988, received statutory powers only on 30th Jan 1992. Under the SEBI Act, a wide variety of powers is vested in the hands of SEBI. SEBI has the powers to regulate the business of stock exchanges, other security markets and mutual funds. Registration and regulation of market intermediaries are also carried out by SEBI. It has the responsibility to prohibit the fraudulent unfair trade practices and insider dealings. Takeovers are also monitored by the SEBI. Stock Exchanges have to submit periodic and annual returns to SEBI. SEBI has the multipronged duty to promote the healthy growth of the capital market and protect the investors.

✓ **The Governing Board**

The Governing Board of the stock exchange consists of elected member directors, government nominees and public representatives. Rules, byelaws and regulations of the stock exchange provide substantial powers to the Executive Director for maintaining efficient and smooth day to day functioning of the stock exchange. The governing Board has the responsibility to maintain and orderly and well regulated market.

The governing body of the stock exchange consists of 13 members of which (a0 6 members of the stock exchange are elected by the members of the stock exchange (b) central government nominates not more than three members. (c) The board nominates three public representatives (d) SEBI nominates persons not exceeding three and (e) the stock exchange appoints one Executive Director. One third of the elected members retire at annual general meeting. The retired member can offer himself for election if he is not elected for two consecutive years. If a member serves in the governing body for two years consecutively, he should refrain from offering himself for another two year.

The members of the governing body elect the President and vice-president. It needs no approval from the Central Government or the Board. The office tenure for the President and Vice-President is one year. They can offer themselves for reelection, if they have not held office for two consecutive years. In that case they can offer themselves for re-election after a gap of one-year period.

✓ **Member of the Stock Exchange**

The Securities Contract Regulation Act of 1956 has provided uniform regulation for the admission of members in the stock exchanges. The qualifications for becoming a member of a recognized stock exchange are given below:

- ✓ The minimum age prescribed for the members is 21 years.
- ✓ He should be neither a bankrupt nor compounded with the creditors.
- ✓ He should not be convicted for fraud or dishonesty.
- ✓ He should not be engaged in any other business connected with a company.
- ✓ He should not be a defaulter of any other stock exchange.
- ✓ The minimum required educational qualification is a pass in 12th examination.

The Mumbai and Calcutta stock exchanges have set up training institutes to enable the members to understand the complexities of the stock trading. In recent days, highly qualified persons such as Company secretaries, charted accountants and MBA's are becoming members. Corporate membership is also permitted now, the members transacting business through their appointed members. The governing board has to approve the partnership and the appointed membership in other stock exchanges. If he applies before the completion of five years he has to relinquish the If membership of the present membership before accepting the other.

- ✓ **The Broker**

A member/broker registered with the recognized stock exchange has to apply to the SEBI for registration. Likewise a sub-broker even though he is registered with the stock exchange should apply to SEBI for registration. Usually the agreement between the broker and the sub broker is carried out on a non-judicial stamp paper of Rs 10. The agreement generally specifies the authority and responsibility of the broker and sub broker. The broker has to abide by the code of conduct laid down by the SEBI. The code of conduct prevents the malpractice, manipulation and gives other statutory requirements. If a broker is involved in manipulation or price rigging or gives false information, his registration is likely to be suspended. If the rules and regulations regarding insiders' trading and take over codes are not adhered to, the registration may even be cancelled.

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Table - Glimpses: Indian Security Market (As on 10-April-2014)

Registered Sub-Brokers in equity segment	51894
Registered Stock Brokers in Equity Derivative Segment	4004
Registered Stock Brokers in Currency Derivative Segment	2754
Registered Stock Brokers in equity segment	9388
Number of Stock Exchanges	22
Registered Foreign Venture Capital Investors	193
Registered Venture Capital Funds	209
Registered Registrar to an Issue & Share Transfer Agent	54
Registered Underwriters	2
Registered Portfolio Managers	225
Registered Merchant Bankers	180
Registered Debenture Trustees	24
Registered Bankers to The Issue	50
Registered Custodians of Securities	19
Registered Investment Advisors	128

Source:- SEBI

- ✓ **Broker and the Investor**

1. The broker should provide adequate information regarding the stocks.
2. The broker should be capable of giving short term and long term investment suggestions to the investors.
3. The broker should be able to confirm the purchase and sale of the securities quickly.
4. He should be able to provide price quotes quickly, which is now possible with the computer network.
5. The broker should be noted for his integrity. He should have a good name in the society.
6. The broker should have adequate experience in the market to take correct decision.
7. The broker should have contact with other stock exchanges to execute the order profitably.
8. The broker should also offer incidental service like arranging for financing the clients' transaction.

2.3.3 Types of Orders

Buy and sell orders are placed with the members of the stock exchanges by the investors. The orders are of different types.

- ✓ **Limit Orders**

Orders are limited by a fixed price. 'Buy Reliance Petroleum at Rs 50'. Here, the order has clearly indicated the price at which it has to be bought and the investor is not willing to give more than Rs 50.

- ✓ **Best Rate Order**

Here, the buyer or seller gives the freedom to the broker to execute the order at the best possible rate quoted on that particular date for buying. It may be the lowest rate for buying and the highest rate for selling.

- ✓ **Discretionary Order**

The investor gives the range of price for purchase and sale. The broker can use his discretion to buy within the specified limit. Generally the approximate price is fixed. The order stands as this 'Buy BRC 100 shares around Rs 40'.

- ✓ **Stop Loss Order**

The orders are given to limit the loss due to unfavorable price movements in the market. A particular limit is given for waiting. If the price falls below the limit, the broker is authorized to sell the shares to prevent further loss. Example -- Sell BRC Ltd at Rs 25, stop loss at Rs 22.

2.3.4 Buying and Selling Shares

To buy and sell shares the investor has to locate a registered broker or sub broker who can render prompt and efficient service to him. Then orders to buy or sell the specified number of shares of a company of the investor’s choice are placed with the broker. The orders may be of any of the above mentioned type. After receiving the order, the broker tries to execute the order in his computer terminal. Once matching order is found, the order is executed. The broker delivers the contract note to the investors. It gives details regarding: the name of the company, number of shares bought, price, brokerage, and date of delivery of shares.

In the physical trading form, once the broker gets the share certificate through the clearing houses he delivers the share certificate along with transfer deed to the investor. The investor has to fill the transfer deed and stamp it. Stamp duty is one-half percentage of the purchase consideration; the investor should lodge the share certificate and transfer deed to the registrar or transfer agent of the company. If it is bought in the demat (Dematerialization) form, the broker has to give a matching instruction to his depository participant to transfer the share bought to the investors’ account. The investor should be an account holder in any of the depository participant. In the case of sale of shares on receiving payment from the purchasing broker, the broker effects the payment to the investor.

- ✓ **Share Groups**

The listed shares are divided into three categories: Group A shares (specified shares) B1 shares and B shares. The last two groups are referred to cleared securities or no-specified shares. The shares that come under specified group can avail the carry forward transactions. In ‘A’ group, shares are selected on the basis of equity, market capitalization and public holding. Further it should have a good track record and a dividend paying company. It should have good growth potential too.

The trading volumes and the investors’ base are high in ‘A’ group share. Any company when it satisfies these criteria would be shifted from ‘B’ group to “A” group. In the B1 group actively traded shares are included. Carry forward transactions are not allowed in this group. Settlement takes place through the clearing house along with the “A” group shares. The settlement cycle and the procedure are identical to “A” group security. The rest of the company shares listed form the B group.

2.3.5 Trading, Clearing, and Settlement

The transactions in the secondary market pass through three distinct phases—trading, clearing, and settlement. While the stock exchanges provide the platform for trading, the clearing corporation determines the funds and the securities obligations of the trading members, and ensures that the trade is settled through the exchange of obligations. The clearing banks and the depositories provide the necessary interface between the custodians/clearing members for the settlement of the funds and securities obligations of the trading members.

Several entities, such as the Clearing Corporation, clearing members, custodians, clearing banks, and depositories are involved in the process of clearing. The role of each of these entities is explained below.

- ✓ **Clearing Corporation**

The clearing corporation is responsible for the post-trade activities, such as risk management and the clearing and settlement of trades executed on a stock exchange. The National Securities Clearing Corporation Ltd. (NSCCL), a wholly owned subsidiary of the NSE, was the first clearing corporation to be established in the country, and was also the first clearing corporation in the country to introduce settlement guarantee. The NSCCL was incorporated in August 1995. It was set up with the objective of bringing and sustaining confidence in the clearing and settlement of securities, promoting and maintaining short and consistent settlement cycles, providing counterparty risk guarantee, and operating a tight risk containment system.

- ✓ **Clearing Members**

Clearing members (CMs) are responsible for settling their obligations as determined by the clearing corporation. They do so by making available funds and/or securities in the designated accounts with the clearing bank/depositories on the date of settlement.

- ✓ **Custodians**

Custodians are clearing members but are not trading members. They settle trades on behalf of the trading members, when a particular trade is assigned to them for settlement. The custodians are required to confirm whether they are going to settle that trade or not. If they confirm to settle that trade, then the clearing corporation assigns that particular obligation to them. As on September 30, 2011, there are 17 custodians empanelled with the NSCCL. They are Axis Bank Ltd., BNP Paribas, Citibank N.A., DBS Bank Ltd., Deutsche Bank A.G., Edelweiss Custodial Services Limited, HDFC Bank Ltd., Hongkong Shanghai Banking Corporation Ltd., ICICI Bank Ltd., Infrastructure Leasing and Financial Services Ltd., JP Morgan Chase Bank N.A., Kotak Mahindra Bank Ltd., Orbis Financial Corporation Ltd., State Bank of India, SBI Custodial Services Pvt. Ltd., Standard Chartered Bank Ltd., and the Stock Holding Corporation of India Ltd.

- ✓ **Clearing Banks**

Clearing banks are a key link between the clearing members and the clearing corporation in the settlement of funds. Every clearing member is required to open a dedicated clearing account with one of the designated clearing banks. Based on the clearing member's obligation as determined through clearing, the clearing member makes funds available in the clearing account for the pay-in, and receives funds in the case of a pay-out. There are 13 clearing banks of the NSE, namely, Axis Bank Ltd., Bank of India Ltd., Canara Bank Ltd., Citibank N.A., HDFC Bank Ltd., HSBC Ltd., ICICI Bank Ltd., IDBI Bank Ltd., IndusInd Bank Ltd., Kotak Mahindra Bank, Standard Chartered Bank, State Bank of India, and Union Bank of India.

- ✓ **Depositories**

A depository holds the securities in a dematerialized form for the investors in their beneficiary accounts. Each clearing member is required to maintain a clearing pool account with the depositories. They are required to make available the required securities in the designated account on settlement day. The depository runs an electronic file to transfer the securities from the accounts of the custodians/clearing member to that of the NSCCL (and vice versa) as per the schedule of allocation of the securities. The two depositories in India are the National Securities Depository Ltd. (NSDL) and the Central Depository Services (India) Ltd. (CDSL).

✓ **Professional Clearing Member**

The NSCCL admits a special category of members known as professional clearing members (PCMs). The PCMs may clear and settle trades executed for their clients (individuals, institutions, etc.). In such cases, the functions and responsibilities of the PCM are similar to those of the custodians. The PCMs also undertake the clearing and settlement responsibilities of the trading members. The PCMs in this case have no trading rights, but have clearing rights, i.e., they clear the trades of their associate trading members and institutional clients.

✓ **Trading Mechanism**

The NSE was the first stock exchange in the country and was set up as a national exchange having nationwide access with a fully automated screen-based trading system. The National Exchange for Automated Trading (NEAT) is the trading system of the NSE. The NEAT facilitates an online, fully automated, nationwide, anonymous, order driven, screen-based trading system. In this system, a member can enter the quantities of securities and the prices at which he/she would like to transact, and the transaction is executed as soon as it finds a matching sale for the buy order for counterparty.

✓ **Clearing and Settlement Process**

The clearing process involves the determination of what the counterparties owe, and which counterparties are due to receive on the settlement date, following which the obligations are discharged by settlement. The clearing and settlement process involves three main activities—clearing, settlement, and risk management. The core processes involved in clearing and settlement include:

a) Trade Recording: The key details about the trades are recorded to provide the basis for settlement. These details are automatically recorded in the electronic trading system of the exchanges.

b) Trade Confirmation: Trades that are meant for settlement by the custodians are indicated with a custodian participant code, and the same is subject to confirmation by the respective custodian. The custodian is required to confirm the settlement of these trades on T+1 day by the cut-off time of 1:00 pm.

c) Determination of Obligation: The next step is the determination of what the counterparties owe, and what the counterparties are due to receive on the settlement date. The NSCCL interposes itself as a central counterparty between the counterparties to trade and net the positions so that a member has a security-wisenet obligation to receive or deliver a security, and has to either pay or receive funds.

The settlement process begins as soon as the members' obligations are determined through the clearing process. The settlement process is carried out by the clearing corporation with the help of clearing banks and depositories. The clearing corporation provides a major link between the clearing banks and the depositories. This link ensures the actual movement of funds as well as securities on the prescribed pay-in and pay-out day.

d) Pay-in of Funds and Securities: This requires the members to bring in their funds/securities to the clearing corporation. The CMs make the securities available in the designated accounts with the two depositories (the CM pool account in the case of the NSDL, and the designated settlement accounts in the case of CDSL). The depositories move the securities available in the pool accounts to the pool account of the clearing corporation. Likewise, the CMs with funds obligations make the funds available in the designated accounts with the clearing banks. The clearing corporation sends electronic instructions to the clearing banks to debit the designated CMs' accounts to the extent of the payment obligations. The banks process these instructions, debit the accounts of the CMs, and credit the accounts of the clearing corporation. This constitutes the pay-in of funds and securities.

e) Pay-out of Funds and Securities: After processing for shortages of funds/securities and arranging for the movement of funds from surplus banks to deficit banks through RBI clearing, the clearing corporation sends electronic instructions to the depositories/clearing banks to release the pay-out of securities/funds. The depositories and clearing banks debit the accounts of the clearing corporation and credit the accounts of CMs. This constitutes the pay-out of funds and securities.

✓ **Settlement Cycle**

The NSCCL clears and settles trades as per the well-defined settlement cycles (Table A). All the securities are traded and settled under the T+2 rolling settlement. The NSCCL notifies the relevant trade details to the clearing members/ custodians on the trade day (T), which are confirmed on T+1 to the NSCCL. Based on this, the NSCCL nets the positions of the counterparties to determine their obligations. A clearing member has to pay-in/pay-out funds and/or securities. The obligations are netted for a member across all the securities to determine his fund obligations and he has to either pay or receive funds. The members' pay-in/pay-out obligations are determined by T+1 at the latest, and are forwarded to them on the same day, so that they can settle their obligations on T+2. The securities/funds are paid-in/paid-out on T+2 day to the members' clients, and the settlement is completed within 2 days from the end of the trading day.

The important settlement types are: Normal Segment (N), Trade for Trade Surveillance (W), Retail Debt Market (D), Limited Physical Market (O), Non-cleared TT Deals (Z), and Auction Normal (A). Trades in the settlement type N, W, D, and A are settled in the dematerialized mode. Trades under the settlement type O are settled in the physical form. Trades under the settlement type Z are settled directly between the members, and may be settled in either the physical or the dematerialized mode.

Table A: Settlement Cycle in CM Segment

	Activity	T+2 Rolling Settlement
Trading	Rolling Settlement Trading	T
Clearing	Custodial Confirmation	T+1
	Delivery Generation	T+1
Settlement	Securities and Funds Pay-in	T+2
	Securities and Funds Pay-out	T+2
	Valuation Debit	T+2.
Post Settlement	Auction	T+2
	Auction Settlement	T+3
	Bad Delivery Reporting	T+4
	Rectified Bad Delivery Pay-in/Pay-out	T+6
	Re-bad Delivery Reporting and pickup	T+8
	Close Out of Re-bad Delivery and funds pay-in & pay-out	T+9

Source:NSE

Note: T+1 means one working day after the trade day. Other T+ terms have similar meanings.

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2.3.6 Price Filters

Abnormal rise or fall in the prices of the securities destroys the investors' confidence and such price fluctuations can lead to high transaction risk. Brokers create instability in prices to earn quick profits. Broker's interest in the stock is initially triggered by market rumors such as takeover, bonus issue, good or bad financial performance and management problems. If the rumors are positive, there would be a scramble for the company's shares. This is done in anticipation of the increase in demand once the information becomes public. Prices can be increased by the traders through circular trading.

Circular trading refers to the trading that takes place among the brokers to manipulate the prices for their personal gain. For example, if there is a rumor about the issue of bonus share by a company, the traders enter into matching deals among themselves (that is buying and sell order) at a price higher than the prevailing market price. Market psychology is that when the price increases investors think that it will go up further and enter into the market. At this juncture, the traders exit booking profits from the transactions. The investors are caught unaware of the real situation. To prevent these happenings price filters are introduced

✓ **Intraday Price Bands**

Here the price range is fixed to restrict the price movement of scrip during a trading session. For example take the case of TVS Suzuki scrip. Suppose, the stock closed on Monday at Rs. 500 at the NSE, it would be allowed to trade on Tuesday only in a 10% percent variation of Monday's close. It would be allowed to trade between Rs. 450 and Rs. 550. The intraday price bank is laid by all the exchanges depending upon the price and volatility of the stock. At NSE the Nifty and Junior Nifty stocks' have 10 per cent and other stocks have five per cent intraday price bands. In August 1997, BSE reduced the filter limit from 10 per cent to5 per cent in 32 stocks because of the uncertain market conditions. Price filter ensures that the stock is traded only within the given range. Transactions beyond the band are rejected by the system. For example if there is an order to buy TVS Suzuki scrip at Rs. 555, the system will not accept the trade.

✓ **Limitations**

The intraday price band does not allow for the proper reaction in prices for the given information. Consider the situation of the Thai currency crisis, it affected exports to that nation and in turn the share prices of some companies might have a retreat. However, the price band places an artificial check on the reaction of the price. If the price band has to be released, the NSE has to get special permission from the SEBI. Secondly, the intraday price band does not curb the automatic price movements within a day. For example, the TVS Suzuki scrip may open on Tuesday at Rs. 470 and rise immediately to an intraday high of Rs. 535 and may finally close at Rs. 485. The sudden increase of Rs. 65 would increase the investment risk due to the heavy transactions that take place on BSE and NSE.

To smoothen the price volatility Madras stock exchange has introduced graded price filters. In MSE, intraday price band prevents an order being executed at Rs. 530 after being opened at Rs. 470. An intermediate price filter is applied at Rs. 468.80 (that is 4 per cent of Rs. 470). If there is no matching order at this price, the stock price is frozen at this level for the day. If the matching is order is found, it would be allowed to rise further by another intermediate price filter level, say 6 percent. Such graded price filters effectively prevent the knee-jerk price movements.

✓ **Inter Week Price Band**

Here the weekly price movements are controlled by applying a weekly price band. The range would be fixed for the weekly price movement. This range is fixed in accordance with the price volatility. The inter week price band is 25 per cent of the previous week's close on Nifty and Junior Nifty stocks.

- ✓ **Margins**

Margins are additional filters applied by the stock exchanges to curb the price volatility. For every transaction undertaken by the broker he has to deposit a margin amount to the stock exchange. The margin amount paid is used as a tool to discourage the speculative and circular trading, it can be made simple with an example, if the MSE were to impose a margin of 20 per cent, traders would have to deposit Rs. 20 with the exchange for every Rs. 100 worth of shares transacted. This would certainly dampen the circular trading. Margins are of different types:

- ✓ **Gross Exposure Margin**

This margin limits the risk exposure of the trader by putting an upper limit to his transaction. This would prevent him from trading beyond his means and the default risk. In the NSE the gross exposure is up to 7 times of the traders base capital, with Rs. 1 lakh he can trade up to Rs. 7 lakh. If it crosses that limit, he has to either switch over his terminal or should bring the gross exposure within the limits or he can deposit additional margin with the exchange to increase the limit.

The enhanced limit would exist for three months. At the end of the period the broker has the choice to continue the present level or revert to the older level. The outstanding exposures at the end of the settlement cycle i.e. Wednesday to Tuesday at NSE and Monday to Friday at BSE, would be added to the first trading day of the next settlement period.

- ✓ **Net Exposure Margin**

Here, the trader has to deposit margins at a graded basis if the purchase is greater than sales in any day. This is imposed to curtail the risk involved in heavy purchase of shares without matching sales. For example, if a trader buys one lakh shares of Reliance at Rs 185 and sells only 30,000 for the net outstanding position of 70,000 shares poses as threat. Hence, the trader has to deposit a margin for the net exposure. Ten per cent margin is for net exposures excess of the total purchase.

- ✓ **Mark to Market Margin**

The gross and net exposure margins try to stabilize the high transaction volume. The risk arises not only through the volume transacted but also through the price volatility. The trader may be able to find a matching order only at a lower price. For example, if Reliance stock price falls from Rs 185/- at the end of the trading session, the exposure risk would be high for the trader.

In the mark to market margin the trader has to deposit a sum that would be a fixed percentage of the product of the difference between the closing selling and purchasing price and the outstanding net position at the end of the day. This would be 50% of the price difference on the scrips, which fluctuate by 5% in a day or 10% over a settlement period. This margin is not imposed on share with market value of Rs 50 or less. In our example the Reliance share price closes at Rs 180, the broker has to deposit Rs. 1,75000 = .5(185-180×70,000). If, the trader buys two stocks and if, one of the stocks closed at Rs

5 higher and other Rs 5 lower the exchange makes the trader to deposit the margin for the latter transaction not for the first transaction. This mark to market margin is refunded by the stock exchange to the concerned broker at the end of the settlement period.

2.3.7 Carry Forward Transactions

In the specified group, shares settlements can be done in three ways (a) delivery against payment (b) squaring up of the transaction(i.e. a purchase is offset by sales and vice-versa) (c) carrying over the settlement to next settlement period. The first two types are simple but the third one is complex. It can be explained by an example.

'Vyaj badla trades', one of the most popular features of India's stock markets in the 1990s, before being banned, are set to make a comeback in a more refined version. In a bid to increase its market share ahead of the launch of MCX-SX, the Bombay Stock Exchange (BSE) will offer a new derivative product known as Cash Futures Spread (CFS). This, brokers say, is similar to the badla system that was used for carry forward trades in the absence of stock futures. But CFS would be less risky and more transparent than its earlier avatar. Vyaj means interest in Gujarati, and badla was a financing mechanism in which money or shares were provided for funding carry-forward deals. The BSE was then a monopoly exchange in the segment and trades worth hundreds and thousands of crores were executed daily using vyaj badla.

The new product, the brainchild of the BSE's interim CEO and MD Ashish Chauhan, will take away the evil of back-room financing deals that were a headache for the regulator in the earlier badla system. According to the BSE, the CFS scheme will be made available to all stocks in the derivative segment. Under it, a trader can enter cash and futures spread trades as a single order. For instance, if Reliance Industries is trading at Rs 700 in cash and at Rs 710 in the futures segment, the exchange under CFS will put out a spread quote of Rs 10. Three cash-future spread quotes will be available for trading at any time, corresponding to the current-, near- and far-month futures contracts on that underlying asset.

The spread here is nothing but the cost of carry for the trader in the futures segment and interest on financing for another trader who wants to deploy his money/share. And as a matter of convenience, all this will be possible in just a single order, without the hassles of financing deals. During settlement, the one who has purchased the shares will get delivery at the agreed spread price at a later date and the other his interest. The technique can also be played in a reverse manner for the seller of the share, earlier known as 'undha (reverse) badla'. The BSE will put out more operational details regarding the scheme during the week. Exchange officials say attracting initial liquidity may not be a big issue for CFS, as the product will be under a market-making scheme from the first day itself.

Currently, if one wants to take advantage of the spread between cash and future, they have to enter four different trades i.e. buy in futures and sell in cash and then reverse the trade to square off the position. This involves the risk of price fluctuation and the cost is also high as four transactions or orders are executed.

(In 1990's Used for carry forward of positions or trades in absence of stock futures Vyaj, meaning interest in Gujarati, was cost of financing the carry-forward Financing deals, conducted off the exchange platform, lacked transparency Sebi banned badla after the Harshad Mehta and Ketan Parekh scams-NOW-Removes back-room financing deals Trader can enter cash and futures spread trades in a single order BSE will put out a spread, between cash and future of a particular security, as price quote Will bring down cost of trading as it may lower STT on delivery trades)

2.3.8 On-line Trading System

A revolutionary change of great significance has taken place with the introduction of on-line trading system, which has replaced the traditional system. The Bombay Stock Exchange introduced this system, which is known as Bombay Stock Exchange On-Line Trading (BOLT).

Under the On-Line Trading System, the trading floor dealings have been discarded. Brokers transact business through their computers, which are linked with the main computer of the Stock Exchange through VSATs (Very Small Aperture Terminals), which have started functioning at various centers. This facility has been extended to other cities also where a stock exchange is already present. **A** Memorandum of Understanding (MoU) between BSE and other exchanges is signed to allow BSE to install its terminals in their areas. The ***modus*** operandi of On-Line Trading is very simple. As soon as a broker receives an order from his customer, he feeds the details of the order into the computer, e.g. the name of company, no. of shares to be purchased/ sold, the ceiling price or the price at which the transaction is intended to be made and the time within which is to be completed.

The screen of the computer will fully display the present details regarding the security concerned. If the present position does not facilitate the transaction, the computer will store the order and will match it with a corresponding reverse order, as soon as it is feasible. 'It means that as and when the desired shares are available for sale at the desired price, the deal is struck and the computer screen will display the completion of the transaction. The broker will, thereafter, issue the contract note.

There are several advantages of the On-Line Trading System. It makes the securities market transparent, as the customer can himself see the market price on the screen. It makes the security market wide and deep. It serves a larger number of investors spread over different locations and covers a large number of securities. The difference in prices of securities at different locations/markets is reduced. It is very convenient, fast and efficient. Other exchanges have also been permitted to set-up computerized screen based trading system. They can also expand nation-wide subject to certain conditions.

2.3.9 Dematerialization of Securities

One of the most important reforms in the Indian Capital Market has been the introduction of dematerialization of securities. Dematerialization means that the securities do not exist in the physical form, i.e. in the form of share/ bond certificates, but holding of such securities are only recorded in the books of an institution called Depository. Whenever, a shareholder transfers his shares to another person, he informs the Depository which makes necessary entries in its books to record such transaction. Thus, the transfer process is facilitated and made foolproof without various disadvantages of physical transfer of shares.

About 80% of the scrips listed on the stock markets have been dematerialized by October, 2001. For dematerialization, investors have to open an account with any of the participants and return the share certificates to the company which destroys them and book entities are made in electronic form by the depository.

2.3.10 Derivatives Trading

The emergence and growth of the market for derivative instruments can be traced back to the willingness of risk- averse economic agents to guard themselves against uncertainties arising out of fluctuations in asset prices. Derivatives are meant to facilitate the hedging of price risks of inventory holdings or a financial/commercial transaction over a certain period. By locking in asset prices, derivative products minimize the impact of fluctuations in asset prices on the profitability and cash flow situation of risk-averse investors, and thereby, serve as instruments of risk management. By providing investors and issuers with a wider array of tools for managing risks and raising capital, derivatives improve the allocation of credit and the sharing of risk in the global economy, lowering the cost of capital formation and stimulating economic growth. Now that world markets for trade and finance have become more integrated, derivatives have strengthened these important linkages between global markets, increasing market liquidity and efficiency, and have facilitated the flow of trade and finance.

India’s tryst with derivatives began in 2000 when both the NSE and the BSE commenced trading in equity derivatives. In June 2000, index futures became the first type of derivate instruments to be launched in the Indian markets, followed by index options in June 2001, options in individual stocks in July 2001, and futures in single stock derivatives in November 2001. Since then, equity derivatives have come a long way. New products, an expanding list of eligible investors, rising volumes, and the best risk management framework for exchange-traded derivatives have been the hallmark of the journey of equity derivatives in India so far.

India’s experience with the equity derivatives market has been extremely positive. The derivatives turnover on the NSE has surpassed the equity market turnover. India is one of the most successful developing countries in terms of a vibrant market for exchange-traded derivatives. This reiterates the strengths of the modern development in India’s securities markets, which are based on nationwide market access, anonymous electronic trading, and a predominant retail market. There is an increasing sense that the equity derivatives market plays a major role in shaping price discovery.

2.4 Summary

The industrial security market in India consists of New Issue Market and Stock Exchange. The new issue market deals with the new securities which were not previously available to the investing public, i.e. the securities that are offered to the investing public for the first time. The market, therefore, makes available a new block of securities for public subscription. The new issue market encompasses all institutions dealing in fresh claim. These claims may be in the form of equity shares, preference shares, debentures, right issues, deposits etc. All financial institutions which contribute underwrite and directly subscribe to the securities are part of new issue market. Whereas the market where existing securities are traded is referred to as the secondary market or stock market. In a stock market, purchase and sales of securities whether of Government or Semi-Government bodies or other public bodies and also shares and debentures issued by joint stock companies are traded.

2.5 Self Assessment Questions

1. Discuss in detail 'New Issue Market'.
2. Explain the functions of New Issue Market
3. What are the different methods of floating the new issues in market?
4. Which are the principal steps in public issue?
5. Describe in detail the pre-issue management?
6. Describe in detail the post issue management.
7. Define following :(a) ESOP (b). ASAB (c). Red herring prospectus (d). QIB (e). French Auction Method
8. What do you mean by Secondary Market? How it is different from Primary Market?
9. What are the functions of stock exchanges?
10. State the provisions for Promoter's capital norms as laid down in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

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See for details:

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Unit : 3 - Corporate and Government Securities Market

Structure of Unit:

3.0 Objectives

After completing this unit, you would be able to:

- Understand the concept of corporate securities and government securities;
- Classify the corporate securities as ownership securities and creditorship securities;
- Point out various types of shares or ownership securities or capital stock;
- Know about various kinds of equity shares, preference shares and debentures and their features also;
- Learn and appreciate the significance of equity, preference shares and debentures for business and investors as well;
- Understand difference between equity shares and debentures;
- Know the features, types and importance of government securities in Indian security market;
- Understanding the complex trading mechanism of Indian Government Securities market;

3.1 Introduction

Raising capital is a most important method of raising long-term funds. Those funds can be invested in long-term or permanent assets like land and building, plant and machinery, furniture etc. Companies issue different types of securities to get funds from different types of investors. Those who want safety and regular income go for debentures. Those who like adventures and aspire for capital appreciation opt for equity shares and those who want regular income but less safety purchase preference shares. There are also some investors who do not prefer to take any kind of risk but want continuous and constant returns. These investors opt for the government issued securities.

The debt market in India consists of mainly two categories—the government securities or the G-Sec markets comprising central government and state government securities, and the corporate bond market. In order to finance its fiscal deficit, the government floats fixed income instruments and borrows money by issuing G-Secs that are sovereign securities issued by the Reserve Bank of India (RBI) on behalf of the Government of India. The corporate bond market (also known as the non-G-Secs market) consists of financial institutions (FI) bonds, public sector units (PSU) bonds, and corporate bonds/debentures.

The G-Secs are the most dominant category of debt markets and form a major part of the market in terms of outstanding issues, market capitalization, and trading value. It sets a benchmark for the rest of the market. The market for debt derivatives have not yet developed appreciably, although a market for OTC derivatives in interest rate products exists. The exchange-traded interest rate derivatives that were introduced recently are debt instruments; this market is currently small, and would gradually pick up in the years to come.

3.2 Corporate Securities

Security is a written evidence of ownership conferring the right to receive property not currently in possession of the holder. The most common types of securities are stocks and bonds or debentures, of which there are many particular kinds designed to meet specialized needs. Corporate securities deals mainly with the buying and selling of securities issued by private corporations. The corporate securities that are dealt in primary market can be classified under two categories:

3.2.1 Ownership Securities or Capital Stock.

3.2.2 Creditorship Securities or Debentures.

3.2.1 Ownership Securities or Capital Stock:

The term 'ownership securities', also known as 'capital stock' represents shares. Shares are the most universal form of raising long-tem funds from the market. Every company, except a company limited by guarantee, has a statutory right to issue shares. Different types of shares are issued to suit the requirements of investors. The instruments used by the corporate sector to raise funds are selected on the basis of—(i) investor preference for a given instrument and (ii) the regulatory framework, where under the company has to issue the security. Investor preferences vary with their attitude towards risk, and their investment goals and investment horizon. The tax liability of the investor too affects the choice of investment media. The firm on the other hand, is affected by the debt-equity ratio permissible, SEBI Regulations on issue of capital, and the formalities to be complied with while raising an issue. So, different types of shares suit different types of investors. The various kinds of shares are:

a) Equity Shares:

Equity share capital is procured by selling ordinary or common shares either be private placement or be issuing a prospectus or by both. Holders of such shares become the owners of the company and can participate in the management of the company indirectly through an elected board of directors. By virtue of their ownership, they have a right to vote in proportion to their shareholding either in person or through proxy. The most outstanding feature of equity capital is that its holders control the affairs of the company and have an unlimited interest in the company's profits and assets. They enjoy voting right on all matters relating to the business of the company. They may earn dividend at a higher rate and have the risk of getting nothing. Along with the privilege of being owners, they have also to bear the risk and carry out certain responsibilities. Their main drawback is that they are the residual claimants in the income as well as in the assets of the company and hence are often termed as 'risk-capital'.

- **Features of Equity Shares:**

Equity shares have a number of features which distinguish it from other securities. The important features are:

(i) **Maturity**: equity shares provide permanent capital to the company and cannot be redeemed during the life time of the company. Equity shareholders can demand refund of their capital only at the time of liquidation of a company. Even at the time of liquidation, equity capital is paid back after meeting all other prior claims including that of preference shares.

(ii) **Right to Income:** As you know, equity shareholders have a claim to the residual income, that is, the income left after paying expenses, interest charges, taxes, preference dividend, if any. Usually, a part of the residual income is distributed in the form of dividend to the shareholders and other part called retained earnings is reinvested in the business. Retained earnings are ultimately benefit the shareholders in the form of firm's enhanced value and earning power and ultimately increase dividend and capital gain of the shareholders. Thus, dividends benefit the shareholders in the form of immediate cash flows whereas the retained earnings give them benefit in the form of capita] gains but not immediately.

(iii) **Claim on Assets:** In case of liquidation of the company, equity shares are the last ones to be paid. They are paid after the claim of debt-holders and preference shareholders have been satisfied. In case of liquidation due to bad financial state of affairs, the equity shareholders generally remain unpaid.

(iv) **Right to Control:** Right to control here means the power to take decisions, frame major policies and power to appoint directors. Equity shareholders have the legal power to elect directors on the board and also to replace them if the board fails to protect interest of the shareholders.

(v) **Voting Rights:** Each equity share carries one vote. Directors are elected in the annual general meeting by the majority votes. Thus, every shareholder can participate in the vital affair of election of directors and cast his vote depending on the number of shares held by him. Shareholders are entitled to vote in person or by proxy.

(vi) **Limited Liability:** In a company limited by shares, an equity shareholder's liability is limited to the amount of investment in his respective share. If his shares are fully paid up, he doesn't have to contribute anything in the event of financial stress or winding up of his company. Whereas in case of a sole-trader concern or a partnership firm, the liability of owner/owners is unlimited which requires them to sell their personal assets and satisfy the claims of creditors in the event of insolvency of these firms.

- **Advantages of Equity Shares:**

Advantages to company: The advantages of issuing equity shares may be summarized as below:

(i) **Long-term and Permanent Capital:** It is a good source of long-term finance. A company is not required to pay-back the equity capital during its life-time and so, it is a permanent source of capital.

(ii) **No Fixed Burden:** Unlike preference shares, equity shares suppose no fixed burden on the company's resources, because the dividends on these shares are subject to availability of profits and the intention of the board of directors. They may not get the dividend even when company has profits. Thus they provide a cushion of safety against unfavourable development.

(iii) **Credit worthiness:** Issuance of equity share capital creates no change on the assets of the company. A company can raise further finance on the security of its fixed assets.

(iv) **Risk Capital:** Equity capital is said to be the risk capital. A company can trade on equity in bad periods on the risk of equity capital.

(v) **Dividend Policy:** A company may follow an elastic and rational dividend policy and may create huge reserves for its developmental programmes.

- ***Advantages to Investors:*** Investors or equity shareholders may enjoy the following advantages:

(i) **More Income:** Equity shareholders are the residual claimant of the profits after meeting all the fixed commitments. The company may add to the profits by trading on equity. Thus equity capital may get dividend at high in boom period.

(ii) **Right to participate in the Control and Management:** Equity shareholders have voting rights and elect competent persons as directors to control and manage the affairs of the company.

(iii) **Capital profits:** The market value of equity shares fluctuates directly with the profits of the company and their real value based on the net worth of the assets of the company. An appreciation in the net worth of the company's assets will increase the market value of equity shares. It brings capital appreciation in their investments.

(iv) **An Attraction of Persons having Limited Income:** Equity shares are mostly of lower denomination and persons of limited recourses can purchase these shares.

(v) **Other Advantages:** It appeals most to the speculators. Their prices in security market are more fluctuating.

- **Disadvantages of Equity Shares:**

Disadvantages to company: Equity shares have the following disadvantages to the company:

(i) **Dilution in control:** Each sale of equity shares dilutes the voting power of the existing equity shareholders and extends the voting or controlling power to the new shareholders. Equity shares are transferable and may bring about centralization of power in few hands. Certain groups of equity shareholders may manipulate control and management of company by controlling the majority holdings which may be detrimental to the interest of the company.

(ii) **Trading on equity not possible:** If equity shares alone are issued, the company cannot trade on equity.

(iii) **Over-capitalization:** Excessive issue of equity shares may result in over-capitalization. Dividend per share is low in that condition which adversely affects the psychology of the investors. It is difficult to cure.

(iv) **No flexibility in capital structure:** Equity shares cannot be paid back during the lifetime of the company. This characteristic creates inflexibility in capital structure of the company.

(v) **High cost:** It costs more to finance with equity shares than with other securities as the selling costs and underwriting commission are paid at a higher rate on the issue of these shares.

(vi) **Speculation:** Equity shares of good companies are subject to hectic speculation in the stock market. Their prices fluctuate frequently which are not in the interest of the company.

- ***Disadvantages to investors:*** Equity shares have the following disadvantages to the investors:

(i) **Uncertain and Irregular Income:** The dividend on equity shares is subject to availability of profits and intention of the Board of Directors and hence the income is quite irregular and uncertain. They may get no dividend even three are sufficient profits.

(ii) **Capital loss During Depression Period:** During recession or depression periods, the profits of the company come down and consequently the rate of dividend also comes down. Due to low rate of dividend and certain other factors the market value of equity shares goes down resulting in a capital loss to the investors.

(iii) **Loss on Liquidation:** In case, the company goes into liquidation, equity shareholders are the worst suffers. They are paid in the last only if any surplus is available after every other claim including the claim of preference shareholders is settled. It is evident from the advantages and disadvantages of equity share capital discussed above that the issue of equity share capital is a must for a company, yet it should not solely depend on it. In order to make its capital structure flexible, it should raise funds from other sources also.

b) Preference Shares:

Preferred or Preference shares, also called premium shares, are shares of a company's stock that entitle holders to a guaranteed periodic dividend. Preference Share Capital is often considered as a hybrid form of financing because it has many features of both equity shares and debenture. Though preferred shares do not entitle holders to the voting rights of ordinary shareholders and quantitatively represent the same amount of ownership for a higher price, preferred shares are prioritized over ordinary shares in asset liquidation, in the event of bankruptcy.

- **Types of Preference Shares:**

Preference shares may be classified according to the rights attached to them. The following types of preference shares are generally issued in India:

Cumulative and Non-cumulative Preference shares: Cumulative preference shares enjoy the right to receive the dividend in arrears for the years in which company earned no profits or insufficient profits, in the year in which company earns profits. In other words, dividend on these shares will go on accumulating until it is paid in full with arrears, before any dividend is paid on equity shareholders. In case of non-cumulative preference shares dividend does not accumulate and therefore, no arrears of dividend will be paid in the year of profits. If company does not have any profits in a year, no dividend will be paid to non-cumulative preference shareholders. Unless there is a specific provision in the Articles of Association of the company, the preference shareholders have no right to participate in the surplus profits or in the surplus assets in a winding up.

Redeemable and Irredeemable Preference Shares: Redeemable preference shares can be redeemed on or after a period fixed for redemption under the terms of issue or after giving a proper notice of redemption to preference shareholders. The Companies Act, however, imposes certain restrictions for the redemption of preference shares. Irredeemable preference shares are those shares which cannot be redeemed during the lifetime of the company.

Convertible and Non-convertible preference shares: Where the preference shareholders are given a right to convert their holding into ordinary shares, within a specified period of time, such shares as known as convertible preference shares. The holders of non-convertible preference shares have no such right of conversion.

Participating and Non-participating Preference Shares: The holders of participating preference shares have a right to participate in the surplus profits of the company remained after paying dividend to the ordinary shareholders and preference shareholders at a fixed rate. The preference shares which do not have such right to participate in surplus profits, are known as non-participating preference shares.

Protected or Guaranteed preference shares: In case of protected preference shares, the company sets up a separate reserve fund out of which the fixed rate of dividend can be paid in years of no-profit or low-profits. In case of guaranteed preference shares, payment of dividend at the fixed rate (irrespective of profits or no-profits) is guaranteed by a third party or institution. This means that in case the company in not in a position to pay dividend the guarantor has to pay such dividend.

- **Features of Preference Shares:**

Preference shares have several features. Some of them are common to all types of preference shares while others are specific to some of them. The following are the most significant features of preference shares:

(i) **Maturity.** Generally, preference shares resemble equity shares in respect of maturity. These are perpetual (irredeemable) and the company is not required to repay the amount during its life time. It is only at time of liquidation that a company has to repay the preference shareholder after meeting the claim of creditors but before paying the equity shareholders.

(ii) **Claim on Income and Assets.** Preference shares have a prior claim on the company's income/dividends during its life time and prior claim on the assets of the company in the event of liquidation. Preference capital is paid after that of a debenture and before that of equity shares.

(iii) **Voting Rights.** Preference shareholders have no voting right but they are granted voting right if the company skips preference dividend for three years.

(iv) **Fixed Dividend.** The dividend rate paid to the preference shareholders is fixed and dividends are not tax deductible also. There is no legal obligation to pay preference dividend. A company doesn't have to face bankruptcy or legal action if it skips preference dividend except granting the voting right as explained above.

If the preference shares are cumulative, it protects the preference shareholders. Cumulative dividends feature added with preference shares means that all past unpaid preference dividend will be paid before any ordinary dividends are paid.

(v) **Redemption.** Redeemable preference shares are those which have a specified maturity date whereas irredeemable preference shares are permanent or perpetual which are payable only in the event of winding up of a company.

(vi) **Call Feature.** The call feature permits the company to buy back preference shares at a stipulated buy-back price or cell price. Call price may be higher than the par value or lower than the par value. The difference between call price and par value of the preference share is called call premium.

(vii) **Tax-Exempt.** Preference shares are tax-exempt in the hands of investors. The paying company, however, is required to pay & dividend tax of 10 percent.

- **Advantages of Preference Shares:**

Preference shares provide a number of advantages both to the company as well as investors or shareholders. The advantages of Preference shares are as follows:

(A) Advantages from Company point of view: The company has the following advantages by issue of preference shares.

(i) **Fixed Return:** The dividend payable on preference shares is fixed that is usually lower than that payable on equity shares. Thus they help the company in maximizing the profits available for dividend to equity shareholders.

(ii) **No Voting Right:** Preference shareholders have no voting right on matters not directly affecting their right hence promoters or management can retain control over the affairs of the company.

(iii) **Flexibility in Capital Structure:** The company can maintain flexibility in its capital structure by issuing redeemable preference shares as they can be redeemed under terms of issue.

(iv) **No Burden on Finance:** Issue of preference shares does not prove a burden on the finance of the company because dividends are paid only if profits are available otherwise no dividend.

(v) **No Charge on Assets:** No-payment of dividend on preference shares does not create a charge on the assets of the company as is in the case of debentures.

(vi) **Widens Capital Market:** The issue of preference shares widens the scope of capital market as they provide the safety to the investors as well as a fixed rate of return. If company does not issue preference shares, it will not be able to attract the capital from such moderate type of investors.

(B) Advantages from Investors point of view: Investors in preference shares have the following advantages:

(i) **Regular Fixed Income:** Investors in cumulative preference shares get a fixed rate of dividend on preference share regularly even if there is no profit. Arrears of dividend, if any, is paid in the year's) of profits.

(ii) **Preferential Rights:** Preference shares carry preferential right as regard to payment of dividend and preferential as regards repayment of capital in case of winding up of company. Thus they enjoy the minimum risk.

(iii) **Voting Right for Safety of Interest:** Preference shareholders are given voting rights in matters directly affecting their interest. It means their interest is safeguarded.

(iv) **Lesser Capital Losses:** As the preference shareholders enjoy the preferential right of repayment of their capital in case of winding up of company, it saves them from capital losses.

(v) **Fair Security:** Preference share are fair securities for the shareholders during depression periods when the profits of the company are down.

- **Disadvantages of Preference Shares:**

In spite of many advantages, preference shares suffer from many shortcomings from investors as well as companies point of view, which are as follows:

(A) Demerits for companies: The following disadvantages to the issuing company are associated with the issue of preference shares.

(i) **Higher Rate of Dividend:** Company is to pay higher dividend on these shares than the prevailing rate of interest on debentures of bonds. Thus, it usually increases the cost of capital for the company.

(ii) **Financial Burden:** Most of the preference shares are issued cumulative which means that all the arrears of preference dividend must be paid before anything can be paid to equity shareholders. The company is under an obligation to pay dividend on such shares. It thus, reduces the profits for equity shareholders.

(iii) **Dilution of Claim over Assets:** The issue of preference shares involves dilution of equity shareholders claim over the assets of the company because preference shareholders have the preferential right on the assets of the company in case of winding up.

(iv) **Adverse effect on credit-worthiness:** The credit worthiness of the company is seriously affected by the issue of preference shares. The creditors may anticipate that the continuance of dividend on preference shares and suspension of dividend on equity capital may deprive them of the chance of getting back their principal in full in the event of dissolution of the company, because preference capital has the preference right over the assets of the company.

(v) **Tax disadvantage:** The taxable income is not reduced by the amount of preference dividend while in case of debentures or bonds, the interest paid to them is deductible in full.

(B) Demerits for Investors: Main disadvantages of preference shares to investors are:

(i) **No Voting Right:** The preference shareholders do not enjoy any voting right except in matters directed affecting their interest.

(ii) **Fixed Income:** The dividend on preference shares other than participating preference shares is fixed even if the company earns higher profits.

(iii) **No claim over surplus:** The preferential shareholders have no claim over the surplus. They can only ask for the return of their capital investment in the company.

(iv) **No Guarantee of Assets:** Company provides no security to the preference capital as is made in the case of debentures. Thus their interests are not protected by the assets of the company.

c) Deferred Shares:

Deferred shares are a form of stock that is sometimes issued to key people within the issuing company. Usually, executives or directors of the company are eligible to receive deferred shares of stock. As part of a deferred share issue, the holders of the shares may not redeem them as long as they are in the employ of the company. Holders of deferred shares usually do not have any voting rights.

A share that does not have any rights to the assets of a company undergoing bankruptcy until all common and preferred shareholders are paid. A method of stock payment to directors and executives of a company through the deposit of shares into a locked account and, hence, tend to provide larger dividend payouts than either common stock or preferred stock. The values of these shares fluctuate with the market and cannot be accessed by the beneficiary for the purpose of liquidation until they are no longer employee of the company. When the employee is no longer with the company, the shares are converted to preferred or common shares at the current market value. A share generally issued to company founders that restricts their receipt of dividends until dividends have been distributed to all other classes of shareholders. Today, the deferred share strategy is not utilized as a viable option for a retirement program and can work very well for smaller companies.

d) **No Par Stock/Shares:**

No-par stock is stock issued with no par or face value. No-par stock has become the most common type of stock issued by corporations and presents tax advantages, since most states tax based on par value. In most jurisdictions, the par value of a stock is the lowest possible price at which a company could issue stock, and amounts equivalent to the aggregate par values of the stock were required to have special treatment as stated capital in accounting. No-par stocks often require the board of directors of a company to determine a stated value when issuing no-par stock to replace the par-determined capital amounts. Some U.S. states do not allow corporations incorporated in the state to issue no-par stock. In these states stock's par values are often extremely low relative to the trading value of the shares.

Share issued with no par value specified either on the share certificate or in the issuer firm's charter or prospectus. The objectives of its issuance include:

- avoidance of taxes levied according to the share's face value;
- avoidance of the issuer firm's liability to shareholders in the event the shares have to be sold at a discount, and
- elimination of investor confusion over the par value and the real (market) value of the share.

Cash proceeds from the share-sale are accounted for by debiting the cash account and crediting the capital share account, thus assigning an implicit value to the issued shares.

No par value shares may be disadvantageous to shareholders where the firm lowers the value of already issued shares by accepting lower price for the new issue.

- **Shares with Differential Voting Rights (DVRs):**

A DVR share is like an ordinary equity share, but it provides fewer voting rights to the shareholder. Companies issue DVR shares for prevention of a hostile takeover and dilution of voting rights as it helps strategic investors who do not want control, but are looking at a reasonably big investment in a company. It offers both retail and institutional investors a variation, especially for those who may not be as particular about voting rights, but may see economic value in the form of higher discount offer that is being made and also for the incremental dividend.

The Companies Act permits a company to issue DVR shares when, among other conditions, the company has distributable profits and has not defaulted in filing annual accounts and returns for at least three financial years. However, the issue of such shares cannot exceed 25 per cent of the total issued share capital.

e) Sweat equity:

The Companies Act of 1956 and the rules as per SEBI Sweat Equity Regulation 2003 allows a company to issue its shares to its employees or directors at a discount or free for consideration other than cash for providing services or knowledge based activities to the company. Sweat Equity can be sold even below the par value. It is a method of recognizing the employees' contribution to intellectual property rights to the company, apart from earning salary, which may be in a form of contribution towards research, strategy, or additions to the companies' profitability.

Valuation of sweat equity can become a contentious issue when there are multiple owners in an enterprise, especially when they are performing different functions. To avoid disputes and complications at a later stage, it may be advisable to arrive at an understanding of how sweat equity will be valued at the outset or initial stage itself. SEBI allows such an issue to a company if (i) such shares have already been issued; (ii) commercial activity has taken placed for at least one year; (iii) the issue has been authorised by special resolution.

3.2.2 Creditorship Securities or Debt Capital:

The term 'creditorship securities', also known as 'debt capital', represents debentures and bonds. They occupy a very significant place in the financial plan of the company. A debenture or bond is an acknowledgement of a debt. It is a certificate issued by a company under its seal acknowledging a debt due by it to its holders. The use of such creditorship securities in financing of a company generally tends to reduce the cost of capital and consequently helps it to improve the earnings for its shareholders.

a) Debentures:

Debentures are creditorship securities representing long-term indebtedness of a company. A debenture is an instrument executed by the company under its common seal acknowledging indebtedness to some person or persons to secure the sum advanced. It is, thus, a security issued by a company against the debt. According to palmer, the world 'debenture' signifies "any instrument under seal evidencing a deed, the essence of it being the admission of indebtedness." In other words debenture is a document creating or acknowledging an indebtedness of the company which may or may not be secured. A debenture is a debt instrument similar to a bond. But bonds are secured while debentures are not. In the United States, the term debentures ordinarily refers to relatively long-term unsecured obligations and in other countries it is used to describe any type of corporate obligation, and "bond" more often refers to loans issued by public authorities.

A public limited company is allowed to raise debt or loan through debentures after getting certificate of commencement of business if permitted by its Memorandum of Association. Debentures are usually secured by the company by a fixed or floating debenture at periodical intervals, generally six months and the company agrees to pay the principal amount at the expiry of the stipulated period according to their terms of issue. Like shares, they are issued to the public at part, at a premium or at a discount.

- **Types of Debentures**

Debenture-holders are creditors of the company and their exact rights depend upon the nature of debentures they hold. Debentures differ on the basis on terms and conditions on which they are issued:

Security:

- **Secured/Mortgage Debentures:** Debentures secured against assets of the company .i.e. if the company is winding up, assets will be sold and debenture holders will be paid back. The charge/mortgage may be fixed or a floating charge. If it is fixed, charge is on a specific asset say plant, machinery etc. If it is floating charge, it means it is on general assets of the company.
- **Unsecured/Naked Debentures:** Debentures not secured against assets of the company .i.e. if the company is winding up, assets will be not be sold in order to pay the debenture holders. In other words, no charge is created on the assets of the company which means that there is no security of interest and principal payment. The creditworthiness and soundness of the company serves as a security.

Tenure:

- **Redeemable Debentures:** Debentures which have to be repaid within a certain specified period. E.g.: 5% 2 years Rs. 1000 debenture means redeemable period is 2 years(5%:interest/coupon payment). After redemption, they can be reissued.
- **Irredeemable/Perpetual Debentures:** These can be paid back at any time during the life of the company .i.e. there is no specified period for redemption. Hence they are also called Perpetual Debentures. Nonetheless if the company has to wind up, then they have to repay the debenture holders.

<u>Registration:</u>

- **Registered Debentures:** As the name suggested, these are debentures that are registered with the company. It records all details of debenture holdings such as name, address, particulars of holding etc. Interest shall be paid only to the registered holder (treated as a non-negotiable instrument). They can be transferred by a transfer deed.
- **Bearer Debentures:** These can be transferred by mere delivery. Company does not hold records for the debenture holder. Interest will be paid to the one who displays the interest coupon attached to the debenture.

<u>Coupon:</u>

- **Zero Coupon Debentures:** Does not have a specified interest rate, thereby to compensate, they are issued at a substantial discount. Interest: Difference in face value and issue price.
- **Specific Coupon rate Debentures:** Debentures are normally issued with an interest rate which is nothing but the coupon rate. It can be fixed or floating. Floating is associated with the bank rates.

<u>Convertibility:</u>

- **Convertible Debentures (Fully/ Partly convertible):** Debentures which can be converted to either equity shares or preference shares by the company or debenture holders at a specified rate after a certain period. A company can also issue **Partly Convertible Debentures** whereby only a part of the amount can be converted to equity/preference shares.
- **Non Convertible Debentures (NCDs):** These can’t be converted into equity/preference shares.

- **Features of Debentures:**

A debenture is a document given by a company as evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge, which contains the following features:

1. **Written promise:** It is an instrument in writing. An oral promise in acknowledgement of a debt is not a debenture. It is an acknowledgement of the indebtedness of the company to its holder for the amount stated in it.
2. **Fixed interest bearing security:** It provides for the payment fixed sum with interest of a specified rate by a specified time. But this is not essential because a company may issue perpetual debentures. Section 120 of the Companies’ Act, 1956, expressly provides for the issue of perpetual or irredeemable debentures w3hich are made payable only in the event of a winding up or some serious default with the company.

3. **Fixed maturity:** Though a company can issue irredeemable debentures also but generally, debenture mature after a specific period. The company has to redeem them at stipulated time ire the debentures holders can force winding up of the company.

4. **Priority in repayment:** Debenture holders have priority of claim on assets of the company, their money has to be paid first before making any payment to preference or equity shareholders in the event of liquidation of the company. Secured debentures have a charge on the assets of the company also.

5. **No participation in management:** Debenture holders are only creditors of the company, unlike equity shareholders they are not part-owners of the company. They have no right to attend general meetings or to vote there in.

6. **Interest on debentures is a charge against profits:** Interest paid on debentures is a charge against the profits of the company and hence is eligible for deduction for income tax purposes.

- **Advantages of Debenture Issue:**

Following are the advantages of debenture issue from the point of view of the company:

(i) **Retention of Control:** Issue of debentures enables the company to raise finances without giving any control over the affairs of the company to debenture holders. They have no voting rights in general meetings of the company.

(ii) **Lower and fixed rate of interest:** Generally, interest on debentures is paid at lower rate than dividends on shares. There may be inflation in future but the rate of interest continues to be the same.

(iii) **Long-term funds:** Debentures are redeemable after quite a long time, hence companies get reliable funds for long-term use.

(iv) **Possibility of trading on equity:** Trading on equity means earning at higher rate on the borrowed funds and paying lower rate of interest on them. By borrowing funds through debentures at lower rate of interest the company can indulge in trading on equity.

(v) **Flexibility in capital structure:** If any time the company sees that it has more than required funds, it can pay back the debentures. This adds to the flexibility in deciding about the capital structure of the company.

(vi) **Income tax benefit:** Interest payable on debentures is treated as charge against profits which reduces the tax benefits. Payment of dividend on the other hand means appropriation of profit which means more tax liability.

From the point of view of investors:

(i) **Security:** Investment in debentures is considered safe and they appeal to cautious investors. A secured debenture holder knows what is the security and there are trustees to guard his interests,

(ii) Regular income: Investors in debentures of good companies are assured of regular income, which is generally at higher rate than income on government securities. Dividends on equity shares are uncertain. The company has to pay interest on debentures even out of the capital, if there are no profits.

(iii) Liquidity: Debentures (Redeemable) are, generally, repayable after a fixed period. Those who want to invest their money for a fixed period prefer debentures. Investment in equity shares is forever, they may not be saleable in the markets if there is no demand for them. Debentures can be lodged with financial institutions as security for loans and can be even sold in the open market.

- **Disadvantages of Debenture Issue**

Companies raising funds through debentures have to faces many difficulties. Issue of debentures suffers from certain limitation from the point of view of the company:

(i) A fixed charge: The company is under legal obligation to pay interest on debentures whether there are profits or not. In bad times it can prove out to be very difficult. If the rate of earning of a company is lower than rate of interest payable on debentures the company will be heading for liquidation. A company unsure about regular income in future cannot afford issue debentures. In the case of redeemable debentures the company has to appropriate profits each year to repay them, unless they are redeemed out of fresh issue, the success of which can be uncertain.

(ii) Need to offer security: The company must have sufficient assets to offer them as security if secured debentures are to be issued. If funds have already been raised against security of assets of the company, it may not be able to issue more secured debentures and the investors may not invest in unsecured debentures.

(iii) High stamp duty: The cost of raising funds through issue of debentures is comparatively high because of high stamp duty stamp duty payable on them.

(iv) Loss of creditworthiness: If the company is heavily in debt due to large scale issue of debentures it loses credibility in the eyes of prospective creditors and the public, which is harmful for its reputation.

From the point of view of investors:

a. **No say in management of the company:** Unlike equity shareholders, debenture-holders have no say in the management of the company and no voting rights also.

b. **Risk:** though the debentures are considered less risky because they are secured, but in practice, many a companies have deflated in payment of interest and repayment of capital. Besides, very few many investors can fight court battle to get the company liquidated, which is their only remedy to get back their money. Even the assets mortgaged as security turn out to be valueless when the company goes into liquidation.

c. **Taxability of interest:** Interest received on debentures is taxable in the hands of debenture holder, while dividend on shares is not.

d. **No claim on surplus assets:** On liquidation of the company, if the debenture holders' money has been repaid in full, they have no claim on its surplus assets. All surplus assets go to equity shareholders.

e. **Fluctuation in value:** The prices of debentures redeemable after a long time keep on fluctuating on the basis of prevailing rate of interest in the market.

3.3 Government Securities

A Government security is a tradable instrument issued by the Central Government, State Government, semi-government bodies, public sector corporations and financial institutions such as IDBI, IFCI, State Financial Corporations' (SFCs) etc. in the form of marketable debt. Government /securities are mostly interest bearing dated securities issued by RBI on behalf of the Government of India. It acknowledges the Government's debt obligation and issued in order to finance the fiscal deficit and managing the temporary cash mismatches of the Government. All entities registered in India like banks, financial institutions, Primary Dealers, firms, companies, corporate bodies, partnership firms, institutions, mutual funds, Foreign Institutional Investors (FIIs), State Governments, Provident Funds, trusts, research organizations and even individuals are eligible to purchase Government Securities. They are held generally by banks and institutions with the Reserve Bank of India in Subsidiary General Ledger accounts. They can be held in special accounts known as Constituent Subsidiary General Ledger (CSGL) accounts which can be opened with banks and Primary Dealers or in dematerialized form in demat accounts maintained with the Depository Participants of NSDL.

Government securities are highly liquid instruments available both in the primary and secondary market. In the primary market Government securities are issued through auctions (yield based or price based auctions) which are conducted by the Reserve Bank of India. Today, funds mobilized through the issue of government securities account for more than ninety per cent of the total amount of funds mobilized on the stock exchanges of India through the issue of all securities. Government securities carry practically no risk of default and, hence, are called risk-free gilt-edged instruments. Since Central Government securities are free of credit risk, they are considered to be safest amongst all type of securities regarding the payment of interest along with the principal amount.

3.3.1 Features of Government Securities Market:

Holding of cash in excess of the day-to-day needs of a bank does not give any return to it. Investment in gold has attendant problems in regard to appraising its purity, valuation, safe custody, etc. Investing in Government securities has the following features

1. **Marketable debt instruments:** These are marketable debt instruments issued by the Central or State Governments, public sector corporations etc.
2. **Sold by the Reserve Bank of India:** The Reserve Bank of India or any bank authorized by it can sell and purchase these securities in the open market. Ma y a times, these are sold to exercise monetary control over the economy.
3. **Fixed rate of interest:** Government securities are issued at face value as well as redeemed at face value on maturity. Interest payment is also on a half yearly basis and the rate of interest and tenor of the security is fixed at the time of issuance and is not subject to change.
4. **Volume of transaction:** the face value of government securities is relatively high, generally Rs. 1000 or move. Transactions in government securities are on very large scale running into thousands of crores. Funds mobilized through government securities amount for more than 80 per cent of the total amount of funds mobilized in stock exchanges.
5. **Safe:** Government securities are considered safest both regarding repayment of the principal and payment of interest. Also, they can be held in book entry, i.e., dematerialized/ scripless form, thus, obviating the need for safekeeping.
6. **Liquid Asset:** Government securities provide ample liquidity as it can be sold easily in the secondary market to meet cash requirements.
7. **Easy settlement cycle:** The settlement system for trading in Government securities, which is based on Delivery versus Payment (DvP), is a very simple, safe and efficient system of settlement. The DvP mechanism ensures transfer of securities by the seller of securities simultaneously with transfer of funds from the buyer of the securities, thereby mitigating the settlement risk.
8. **Form of issue:** Government securities are, generally, issued wither in the form of promissory notes, bearer bonds or stock certificates, the most common form is the promissory note.
9. **Method of issue:** Government securities are issued through Public Debt Department of the Reserve Bank of India or by banks authorized by it. No prospectus is required to be issued and there is no need to get them listed on any stock exchange, only a no objection certificate is required to be obtained from the SEBI which grants it as a matter of routine.
10. **Purpose of issue:** Government securities are issued for (i) meeting fresh cash requirements of governments; (ii) to raise funds for refunding the amount due on maturity of old securities, and (iii) advance refunding of securities which have not matured yet.
11. **Direct deals:** There are direct dealings between the buyer and the seller and with the intervention of a broker if it is at over the counter market.

12. **Tax-free:** Interest on government securities is exempted from income-tax subject to the provisions of section 80-L of the Income Tax Act, 1961. However, interest on securities of local authorities is not exempted from tax.

13. **Investors:** Investors in this market are predominantly the institutions which are statutorily required to invest a certain portion of their funds in government securities. Previously institutional investors were the only participants in government securities market but since December 2001, the RBI has allowed individuals to purchase government securities. The minimum amount for bidding has been fixed at Rs. 10,000 and in multiples of Rs. 10,000.

3.3.2 Types of G-Securities

In India, the Central Government issues T-bills and bonds or dated government securities, while the state governments issue only bonds or dated securities, which are called State Development Loans (SDLs). Government securities carry practically no risk of default, hence, are called risk-free gilt-edged instruments. The Government of India also issued savings instruments such as Savings Bonds, National Saving Certificates (NSCs) and special securities (oil bonds, Food Corporation of India bonds, fertilizer bonds, power bonds, and so on).

- **Treasury Bills**

Treasury Bills are money market instruments, i.e., short term (up to one year) borrowing instruments of the Government of India which enable investors to park their short term surplus funds while reducing their market risk. T-bills are issued in three tenors – 91 days, 182 days and 364 days and are issued at a discount and are redeemed at face value on maturity.

They are auctioned by Reserve Bank of India at regular intervals and the rate of discount and the corresponding issue prices are determined at each auction. When liquidity is tight in the economy, returns on Treasury Bills sometimes become even higher than returns on bank deposits of similar maturity. They are available in both Primary and Secondary Market and any person in India including Individuals, firms, companies, corporate bodies, trusts and Institutions can purchase Treasury Bills. Treasury Bills are available for a minimum amount of Rs. 25,000 and in multiples of Rs. 25,000 thereafter. Treasury Bills are issued in the form of SGL - entries in the books of Reserve Bank of India to hold the securities on behalf of the holder.

- **Cash Management Bills (CMBs)**

Government of India, in consultation with the Reserve Bank of India, has decided to issue a new short-term instrument, known as Cash Management Bills (CMBs), to meet the temporary mismatched in the cash flow of the Government, the CMBs have the generic character of T-bills but are issued for maturities less than 91 days. Like the T-bills, they are also issued at a discount, and are redeemed at face value on maturity. The tenure, notified amount, the date of issue of CMBs depends upon the temporary cash requirement of the government. The announcement of their auction is made by the RBI through a

Press Release that would be issued one day prior to the date of auction, the settlement of the auction is on a T+1 basis.

- **Dated Government Securities**

Dated Government securities are long term securities and carry a fixed or floating coupon (interest rate), which is paid on the face value, payable at fixed time periods (usually half-yearly). The tenor of dated securities can be up to 30 years. The Public Debt Office (PDO) of the RBI acts as the registry/depository of Government securities and deals with the issue, interest payment and repayment of principal at maturity. Most of the dated securities are fixed coupon securities and they are of following types:

(a) *Fixed Rate Bonds* – These are bonds on which the coupon rate is fixed for the entire life of the bond. Most Government bonds are issued as fixed rate bonds.

(b) *Floating Rate Bonds* – Floating Rate Bonds are securities which do not have a fixed coupon rate. The coupon is re-set at pre-announced intervals (say, every six months or one year) by adding a spread over a base rate. In the case of most floating rate bonds issued by the Government of India so far, the base rate is the weighted average cut-off yield of the last three 364- day Treasury Bill auctions preceding the coupon re-set date and the spread is decided through the auction.

(c) *Zero Coupon Bonds* – Zero coupon bonds are bonds with no coupon payments. Like Treasury Bills, they are issued at a discount to the face value. The Government of India issued such securities in the nineties, It has not issued zero coupon bond after that.

(d) *Capital Indexed Bonds* – These are bonds, the principal of which is linked to an accepted index of inflation with a view to protecting the holder from inflation. A capital indexed bond, with the principal hedged against inflation, was issued in December 1997, which matured in 2002. The government is currently working on a fresh issuance of Inflation Indexed Bonds wherein payment of both, the coupon and the principal on the bonds, will be linked to an Inflation Index (Wholesale Price Index).

(e) *Bonds with Call/ Put Options* – Bonds can also be issued with features of optionality wherein the issuer can have the option to buy-back (call option) or the investor can have the option to sell the bond (put option) to the issuer during the currency of the bond.

- **State Development Loans (SDLs)**

State Development Loans (SDL) are issued by the State Governments and RBI coordinates the actual process of selling these securities. Each state is allowed to issue securities up to a certain limit each year. SDLs are dated securities issued through an auction similar to auctions conducted for the dated securities issued by the central government, but the coupon rates on SDLs are marginally higher than those of GOI securities issued for the same maturity.

SDLS are normally sold through multiple price auctions through competitive bidding conducted by RBI. Non-competitive bidding has been introduced in the auction of SDL and they also qualify for SLR status. Interest payment frequency is half yearly and other modalities are similar to GOI securities. They are issued in dematerialized form. State Government Securities can be issued in the physical form (in the form if Stock Certificate) on separate request and are transferable with nonpayment of stamp duty on transfer. They are also eligible as collaterals for borrowing through market repo as well as borrowing by eligible entities from the RBI under the Liquidity Adjustment Facility (LAF).

3.3.3 Trading Mechanism of G-Securities Market

The trading mechanism of the government securities market consists the issuance of the government securities, its holding pattern, listing, reporting and settlement plus clearing of the issued securities.

➢ **Issuance of Government Securities:**

Government securities are issued through auctions conducted by RBI on an electronic platform called the NDS-Auction platform. Commercial banks, schedule urban co-operative banks, primary dealers, insurance companies, and provident funds, who maintain a funds account (current account) and securities account (SGL account) with the RBI are members of this electronic platform. The RBI, in consultation with the Government of India, issues an indicative half-yearly auction calendar, which contains information about the amount of borrowing, the tenor of security, and the likely period during which auctions will be held. The RBI places the notification about the exact details of the securities, including the name, account, type of issue, and the procedure of auction on its website, and also issues an advertisement in leading English and Hindi newspaper. Prior to the introduction of auctions as the method of issuance, the interest rates were fixed by the government. With the introduction of auctions, the rate of interest (coupon rate) gets fixed through a market-based price discovery process. An auction may be either yield-based or price-based:

Yield-based Auction: a yield-based auction is generally conduced when a new government security is issued. Investors bid in yield term up to two decimal places. The bids are arranged in ascending order, and the cut-off yield is arrived at the yield corresponding to the notified amount of the auction. Successful bidders are those who have bid at or below the cut-off yield and others above than the cut-off are rejected.

Price-based Auction: a price based auction is conducted when the Government of India re-issues securities issued earlier. The bidders quote in terms of price per Rs. 100 of the face value of the security. The bids are arranged in descending order, and the successful bidders are those who have bid or above the cut-off price. Bids that are below the cut-off price are rejected.

Multiple Price-based Auction: In a uniform Price auction, all the successful bidders are required to pay for the allotted quantity of securities at the auction cut-off rate, irrespective of the rate allotted by them. On the other hand, in a Multiple Price auction, the successful bidders are required to pay for the allotted quantity of securities at the respective price/yield at which they have bid.

- **Holding of Government Securities**

The Public Debt Office (PDO) of the Reserve Bank of India, Mumbai acts as the registry and central depository for the government securities. Government securities may be held by investors either as physical stock or in dematerialized form. However, from May 20, 2002, it is mandatory for all the RBI regulated entities to hold and transact in government securities only in dematerialized (SGL) form.

Physical form: government securities may be held in the form stock certificates. A stock certificate is registered in the books of the PDO and the owernership cannot be transferred by way of endorsement and delivery. They are transferred by executing a transfer form as the ownership and transfer details are recorded in the books of the PDO.

Demat form: Holding government securities in the dematerialized or scripless form is the safest and the most convenient alternative, as it eliminates the problems relating to custody and the transfers and servicing are electronic and hassle free. The holders can maintain their securities in dematerialized form through:

(i) *SGL Account:* Reserve Bank of India offers Subsidiary General Ledger Account (SGL) facility to select entities who can maintain their securities in SGL accounts maintained with the Public Debt Offices of the Reserve Bank of India.

(ii) *Gilt Account:* As the eligibility to open and maintain an SGL account with the RBI is restricted, an investor has the option of opening a Gilt Account with a bank or a Primary Dealer which is eligible to open a Constituents' Subsidiary General Ledger Account (CSGL) with the RBI. Under this arrangement, the bank or the Primary Dealer, as a custodian of the Gilt Account holders, would maintain the holdings of its constituents in a CSGL account with the RBI. The servicing of securities held in the Gilt Accounts is done electronically and the receipt of maturity proceeds and periodic interest is also faster as the proceeds are credited to the current account of the custodian bank / PD with the RBI.

Investors also have the option of holding Government securities in a dematerialized account with a depository (NSDL / CDSL, etc.). This facilitates trading of Government securities on the stock exchanges.

- **Listing and Trading of G-secs on Stock Exchanges**

There is an active secondary market in Government securities. The securities can be bought /sold in the secondary market either of the three forms:

i. ***Over the Counter (OTC)/ Telephone Market:*** In this market, a participant, who wants to buy or sell a government security, may contact a bank / Primary Dealer / financial institution either directly or through a broker registered with SEBI and negotiate on telephone for a certain amount of a particular security at a certain price. All trades undertaken in OTC market are reported on the secondary market module of the NDS.

ii. ***Negotiated Dealing System:*** The Negotiated Dealing System (NDS) for electronic dealing and reporting of transactions in government securities was introduced in February 2002. It facilitates the members to submit electronically, bids or applications for primary issuance of Government Securities when auctions are conducted. Membership to the NDS is restricted to members holding SGL and/or Current Account with the RBI, Mumbai.

iii. ***Negotiated Dealing System-Order Matching (NDS-OM):*** In August, 2005, RBI introduced an anonymous screen based order matching module on NDS, called NDS-OM. This is an order driven electronic system, where the participants can trade anonymously by placing their orders on the system or accepting the orders already placed by other participants. NDS-OM is operated by the Clearing Corporation of India Ltd. (CCIL) on behalf of the RBI.

- **Merits of G-Securities:**

For an individual, holding government securities offers the following advantages:

i. **No risk:** Being a sovereign paper, government securities are completely free of risk both regarding the principal and the interest.

ii. **No deduction of income-tax at source:** Income tax on interest paid on government securities is not deducted at source. This is a very convenient investment for those who can claim deduction under Income Tax Act.

iii. **Payment of interest at regular intervals:** Interest on government securities is paid on quarterly or half yearly basis (not necessarily on maturity). Retired persons can make it a regular source of income.

iv. **Liquidity:** government securities can be instantly converted into cash. This is possible because buy and sell rates of government securities (called GILTS) are regularly provided on daily basis by most so Primary Dealers.

v. **Assurance of interest at high rates for long period:** If current rates of interest are high and there are changes of reduction in them in future an investor can assure himself of high rates by investing in ling term government securities.

- **Demerits of Government Securities**

  - **Lower rate of return:** The rate of return on government securities is, generally, lower than return on corporate securities.

  - **Loss, if interest rates rise in future:** If an investor invests his money today and there is a rise in market rates of interest in future, his money will remain blocked in low yielding securities for fixed period. If he wants to sell them, these will be sold at a discount.

- **Not regularly traded:** Some government securities are not regularly traded. The market place of inactive securities is, generally lower which can cause loss to the investor.

3.4 Summary

In today's world of dynamic business environment, in order to run and manage a company, funds are required right from the promotional stage up to the end. If funds are inadequate, the business suffers and if funds are not properly managed, the entire organization suffers. The sources of funds are plenty and it is, therefore, necessary that the company themselves opt for the right choice of finance depending up on its requirement, caliber and credibility, so that they can secure maximum returns for their owners. Also, the investors can analyze the risk and return trade-off of different securities offered by the companies and then go for portfolio of their choice and stamina.

3.5 Self Assessment Questions

1. Critically examine the advantages and disadvantages of raising funds by issuing shares of different types.
2. What different forms of securities can public limited company issue? Discuss their significance in detail in relation to the financial structure of a company.
3. As a financial manager of a newly started joint-stock company of a large size, what various sources would you tap to raise funds required for its smooth running? Explain.
4. "Debentures occupy a very important place in the financial plan". Discuss the statement and point out the limitations of debentures financing.
5. How the trading mechanisms of government securities in India work? Discuss the merits and demerits of Government securities.
6. Write short notes on: 1.Shares with differential voting rights, Sweat equity shares, Listing and trading of Government securities in Indian market.

3.6 Reference Books

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Unit : 4 - Market Infrastructure-Stock Exchanges

Structure of Unit:

4.0 Learning Objectives

After completing this unit, you would be able to:

- Understand the concept of stock exchange and its organization in India;
- Know about various major stock exchanges in India;
- Point out the various regional stock exchanges and national level stock exchanges in India;
- Understand the origin, trading, settlement and clearing mechanism of various national level stock exchanges in India;
- Learn about the membership rules for the stock exchanges to be followed in India;
- Classify the various types of members working in the stock exchanges in India;

4.1 Introduction

Over the last few decades, the average person's interest in the stock market has grown exponentially. Stock markets' intricacies are inter-woven in the fabric of a nation's economic life. Without a stock market, the saving of the community would remain underutilized. The task of mobilization and allocation of savings could be attempted in the old days by a much less specialized institution than the stock exchanges. But as business and industry expanded and the economy assumed more complex nature, the need for permanent finance arose. The answer was a ready market for investments and it was how the stock market came into being. These demand coupled with advances in trading technology has opened up the markets, so that nowadays nearly anybody can own stocks.

4.2 What is a Stock Exchange?

Stock exchange is an organized market for the sale and exchange of shares, debentures as well as other financial securities. According to Securities Contract (Regulation) Act, 1956, *"Stock exchange is an association, organization or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities"*. It implies that a stock exchange is a market which provides necessary facilities for transfer of all kinds of securities at competitive rates and without undue delay.

4.3 The Organization of Stock Exchanges in India

The stock exchange in Bombay formed in 1875 is 132 years old. A lot has changed since 1875 when 318 persons became members of what today is called "Bombay Stock Exchange Limited" by paying a princely amount of Re 1.

Table below presents the organization of stock exchange in India. Some are public limited companies (12), while others are limited by guarantees (5), or as voluntary non-profit making organizations (3). National Stock Exchange (NSE) is a tax-paying company incorporated under the Companies Act and promoted by leading financial institutions and banks, while Over the Counter Exchange of India (OTCEI) is registered as a company under Section 25 of the Companies Act, 1956. The Securities Exchange Board of India (SEBI) ensures broad uniformity in structure while granting recognition. SEBI decided in December 1996 that recognition to new stock exchanges, if considered necessary in public interest, and that of trade could be allowed only on "On Line Screen Based Trading" and establishment of clearing house within six months from the date of recognition. Only nine exchanges have got permanent recognition. Others (12) have to renew it every year until permanent recognition is granted.

TABLE 1: Organisational Forms of Various Stock Exchanges

Voluntary non-profit making association	:	*Mumbai, Ahmadabad, Patna, Indore*
Public limited company	:	*Kolkata, Delhi, Bangalore, Cochin, Kanpur, Guwahati, Ludhiana, Mangalore, Chennai*
Company limited by guarantee	:	*Hyderabad, Pune, Rajkot, Magadh*
A tax-paying company incorporated under the Companies Act and promoted by leading financial institutions and banks	:	*National Stock Exchange*
A company under Section 25 of the Companies Act, 1956	:	*Over the Counter Exchange of India*

Source: SEBI, *Annual Reports.*

4.4 Major Stock Exchanges in India

Stock exchanges provide an organized market for transactions in shares and other securities. As of 2003, there are 23 stock exchanges in the country, 20 of them being regional ones with allocated areas of operation. Besides the regional stock exchanges, three national stock exchanges have been set up in India. They are the National Stock Exchange (NSE), Over the Counter Exchange of India Limited (OTCEI), and Inter-connected Stock Exchange of India Limited (ISE). All three exchanges have their head office at Mumbai. Till date, in India, the Bombay Stock Exchange (BSE) is the oldest exchange in country and the National Stock Exchange (NSE) is the largest stock exchange in India. The two exchanges also account for the majority of traded shares in India.

TABLE 2: Exchange-wise Cash Segment Turnover (Rs. Crores)

Stock Exchange	***2010-11***	***2011-12***	***2012-13***	***Percentage Share***
Recognized Stock Exchanges				
Ahmedabad	Nil	Nil	Nil	Nil
BSE	11,05,027	6,67,498	5,48,774	16.8
Bangalore	Nil	Nil	Nil	Nil
Bhubaneshwar	Nil	Nil	Nil	Nil
Coachin	Nil	Nil	Nil	Nil
Coimbatore	Nil	Nil	Nil	Nil
Delhi	Nil	Nil	Nil	Nil
Guwahati	Nil	Nil	Nil	Nil
ISE	Nil	Nil	Nil	Nil
Jaipur	Nil	Nil	Nil	Nil
Calcutta	2,597	5,991	4,614	0.1
Ludhiana	Nil	Nil	Nil	Nil
Madras	Nil	Nil	Nil	Nil
MCX	-	-	33	0.0
MPSE	Nil	Nil	Nil	Nil
NSE	35,77,410	28,10892	27,08,279	83.0
OCTEI	Nil	Nil	Nil	Nil
Pune	Nil	Nil	Nil	Nil
UPSE	0.12	Nil	Nil	Nil
Vadodara	Nil	Nil	Nil	Nil
Total	***46,85,034***	***34,84,381***	***32,61,701***	***100.0***

Source: SEBI Annual Reports.

Notwithstanding the steady pick up in equity prices, there was a fall in the trading volumes in cash segment in 2012-13. The turnover of all the stock exchanges in the cash segment declined by 6.4 percent to Rs. 32,61,701 crores in 2012-13 from Rs. 34,84,381 crore in 2011-12. BSE and NSE together contribute 99.8 percent of the turnover, of which NSE accounted for 83.0 percent in the total turnover in cash market whereas BSE accounted for 16.8 percent to the total.

4.4.1 REGIONAL STOCK EXCHANGES (RSES)

There are twenty-three stock exchanges in the country, 20 of them being regional ones with allocated areas of operation. The number of regional stock exchanges in each of the four zones (east, west, north, and south) that the country can be divided into is given in Table below. The north zone has five stock exchanges and east zone consist of three stock exchanges. The west and south zones have six stock exchanges each.

Table 3: Regional Stock Exchanges in India

North Zone	*East Zone*	*West Zone*	*South Zone*
Kanpur	Bhubaneswar	Ahmadabad	Bangalore
Ludhiana	Kolkata	Vadodara	Chennai
New Delhi	Guwahati	Indore	Kochi
Jaipur		Mumbai	Coimbatore
Meerut		Pune	Hyderabad
		Rajkot	Mangalore

Source: SEBI Annual Reports.

Hence it can be seen from the map that over a period of time, regional stock exchanges came to be set up almost in every State. The objective of establishing the RSEs was to enable regional companies in the respective geographical locations to raise capital and to help spread the equity cult amongst investors across the length and breadth of the country. Reputed local companies could get themselves listed on these exchanges and the regional stock exchanges promoted trading in these local strips. It led to a competition among issuers and they listed their securities on as many exchanges as possible to attract investors from all over the country. Moreover, each regional stock exchange followed its own practice and procedures in respect of listing and trading of securities, clearing and settlement of transactions, and risk containment measures. It resulted in a waste of the resources of the issuers for complying with the listing requirement of a number of exchanges simultaneously. However, with the various changes in the capital market micro structure, the scope of operations of the RSEs became limited. The trading in these RSEs had also dwindled over the past several years.

The regional stock exchanges did well till the beginning of the 1990s. In the 1990s, new stock exchanges ─ Over the Counter Exchange of India (OTCEI), National Stock Exchange (NSE), and Inter-Connected Stock Exchange of India (ICSEI) ─ were set up and permitted nationwide trading. Subsequently, all stock exchanges were permitted to expand across the nation. In spite of the expansion, the turnover of RSEs did not increase with the spread of on-line trading as traders in remote parts of the country could deal directly with NSE or BSE. Besides this, the members of these regional stock exchanges involved themselves in speculation instead of reaching out to new investors and catering to local companies in an efficient manner. With turnovers plunging, most RSEs acquired membership of BSE or NSE and became their stockbrokers. The financial condition of the RSEs is by and large also weak and this state of affairs has been prevailing for the past several years. Moreover, most of the stock exchanges do not have the money to upgrade their IT infrastructure, a prerequisite to survive and compete in the future.

4.4.2 Bombay Stock Exchange (BSE)

A very common name for all traders in the stock market, BSE, stands for Bombay Stock Exchange, which is situated in Dalal Street Mumbai. It was started an informal group of 22 stockbrokers trading under a banyan tree opposite the town hall of Bombay from mid-1850s. This group of stockbrokers formed an association called 'The Native Share and Stockbrokers Association' which, in 1875, was formally organized as the Bombay Stock Exchange (BSE). BSE is the oldest stock exchange in Asia and the first stock exchange in the country to obtain permanent recognition in 1956 from the Government of India under the Securities Contract (Regulation) Act, 1956. In 1955, BSE became screen based trading system.

- **Importance of BSE**

BSE has been a pioneer in many areas. It was the first stock exchange in India to introduce Equity Derivatives. It introduced Free Float Index and enabled the internet trading platform across the country. It was the first to obtain the ISO certification for surveillance, clearing and settlement of trading of securities. It had the facility for financial training and the first stock market to become electronic. It also launched the nationwide investor awareness campaign and dissemination of information through print and electronic media.

- **Management of BSE**

The Exchange is professionally managed under the overall direction of the Board of Directors. The governing body is comprised of 9 elected directors (one-third to retire every year by rotation), an Executive Director, the Government nominees, a Reserve Bank of India nominee and five public nominees who regulate the working of the exchange. However, as per SEBI orders issued in March, 2001, the elected directors have been restrained from acting and Governing Board presently comprises of only 10 directors, which includes eminent professionals, representatives of trading members and the Managing Director of the Exchange. The Executive Director acts as the Chief Executive Director and is responsible for the day-to-day administration of the exchange.

- **The Working of BSE**

The members of the stock exchange can trade in the exchange on behalf of outsiders. If a member trades on his own account, then transactions can be only among stock exchange members. The shares of listed companies only can be traded at the exchange. SEBI has allowed BSE to extend its trading terminals to outsider centres and the Bombay Online Trading System (BOLT) has enabled it to open trade working stations all over the country. BOLT started in March 1995 to bring about transparency and liquidity and to increase market depth. It was started to eliminate mismatches and settlement risks and disseminate information and volumes in trade.

- **Corporatization and Demutualization**

The Securities and Exchange Board of India (SEBI) has approved the scheme for corporatization and demutualization of the stock exchange. The stock market would become a company limited by shares. The ownership and management of BSE Ltd. would be separate from the trading rights of the members. The initial membership will be from cardholders of BSE who will become its shareholder and can also become their trading members. A trading member of BSE will also become a trading member of BSE Ltd. After the organization they will be only one class of trading member with similarity in rights. There will be uniform standards in capital adequacy, deposits and fees. The governing board would be constituted in a manner that the trading members do not exceed one fourth of the total strength of the governing board. The existing assets and reserves would be transferred from BSE to BSE Ltd. There would be at least 51% of equity shares held by public other than the shareholders which have trading rights.

4.4.3 National Stock Exchange (NSE)

Set up in November 1992, NSE was India's first fully automated electronic exchange with a nationwide presence. Based on the recommendations of a high-powered group set up to study the establishment of new stock exchanges, NSE was promoted by leading Financial Institutions at the behest of the Government of India and was incorporated in November 1992 as a tax-paying company unlike other stock exchanges in the country. Established with an equity capital of Rs. 25 crores in 1992, it got recognition as a stock exchange under the Securities Contracts (Regulation) Act, 1956 in April 1993. Headquartered in Mumbai, NSE offers capital raising abilities for corporations and a trading platform for equities, debt, and derivatives ─ including currencies and mutual fund units. Its shareholders consist of 20 financial institutions including state-owned banks and insurance companies.

- **Ownership and Management**

From day one, NSE has adopted the form of a demutualised exchange - the ownership, management and trading is in the hands of three different sets of people. NSE is owned by a set of leading financial institutions, banks, insurance companies and other financial intermediaries and is managed by professionals, who do not directly or indirectly trade on the Exchange. It has completely eliminated any conflict of interest and helped NSE in aggressively pursuing policies and practices within a public interest framework.

The Board of NSE comprises of senior executives from promoter institutions and eminent professionals, without having any representation from trading members. While the Board deals with the board policy issues, the Executive Committees (ECs) set out rules and parameters to manage the day-to-day affairs of the Exchange. The Executive Committee (EC), which is concerned with the management of the exchange, comprises of senior executives from promoter institutions, eminent professionals in the fields of law, economics, accountancy, finance, taxation, etc, public representatives, nominees of SEBI and one full time executive of the Exchange. EC has four brokers nominated by the board to reflect different types of interests in the market. But the exchange has appointed different committees to advice in areas such as best market practices, settlement procedures and risk containment systems. The day-to-day management of NSE is delegated to the Managing Director who is supported by a team of professional staff.

- **Objectives of NSE**

NSE's mission is setting the agenda for change in the securities markets in India. The NSE was set-up with the main objectives of:

(1) Establishing a nation-wide trading facility for equities, debt instruments and hybrids;

(2) Ensuring equal access to investors all over the country through an appropriate communication network;

(3) Providing a fair, efficient and transparent securities market to investors using electronic trading systems, enabling shorter settlement cycles and book entry settlements systems;

(4) Meeting the current international standards of securities markets;

(5) The standards set by NSE in terms of market practices and technologies have become industry benchmarks and are being emulated by other market participants. NSE is more than a mere market facilitator. It's that force which is guiding the industry towards new horizons and greater opportunities.

- **Index**

NSE provides many services and index related services and products. Its main index is the 50 shares S&P CNX NIFTY. The index consists of 50 companies representing 25 sectors of the economy. It represents 47% of the traded value of all stocks on the National Stock Exchange in India. It is calculated as a weighted average, so the changes in the share prices of large companies have an efect. The base is defined as one thousand at the price level of November 3rd, 1995, when the total market capitalization was around 20, 60,000 million. Some of its other indices are CNX Nifty Junior, India VX, S&P CNX Defty, S&P CNX 500, etc.

- **Membership Pattern of NSE**

The trading in NSE has a three tier structure the trading platform provided by the Exchange, the broking and intermediary services and the investing community. The trading members have been provided exclusive rights to trade subject to their continuously fulfilling the obligation under the Rules, Regulations, Byelaws, Circulars, etc. of the Exchange. Any person can become a trading member by complying with the prescribed eligibility criteria and exit by surrendering trading membership without any hidden/overt cost. The Exchange stresses on factors such as corporate structure, capital adequacy, track record, education, experience, etc. while granting trading rights to its members. The exposure and volume of transactions that can be undertaken by a trading member are linked to liquid asset in the form of cash, bank guarantees, etc. deposited by the member with the Exchange as part of the membership requirements. All trading members are registered with SEBI. A prospective trading member is admitted to any of the following combinations of market segments: wholesale Debt Market (WDM) segment; Capital Market (CM) and the Futures and Options (F&O) segments; CM and WDM segment; CM, WDM and F&O segment; Currency Derivatives (CD) segment and CD along with either or all segments listed above.

- **Market Segments of NSE**

NSE provides a trading platform for all types of securities for investors under one roof — Equity, Corporate Debt, Central and State Government Securities, T-Bills, Commercial Paper (CPs), Certificate of Deposits (CDs), Warrants, Mutual Funds (MFs) units, Exchange Traded Funds (ETFs), Derivatives like Index Futures, Index Options, Stock Futures, Stock Options and Currency Futures. The Exchange provides trading in four different segments viz., Wholesale Debt Market (WDM) segment, Capital Market (CM) segment, Futures and Options (F&O) segment and the Currency Derivatives Segment.

(a) The Exchange started its trading operations in June 1994 by enabling the ***Wholesale Debt Market (WDM)*** segment of the Exchange for providing secondary market trading facilities. The segment provides the trading platform and facility for institutions and bodies corporate to enter into high value transactions in instruments such as state and central government securities, treasury bills (T-bills), state development loans (SDLs), bond issued by public sector undertakings (PSUs), floating rate bonds (FRBs), zero coupon bonds(ZCBs), index bonds, commercial papers (CPs), certificate of deposits (CDs), corporate debentures, SLRs and non-SLR bonds issued by financial institutions (FIs), bonds issued by foreign institutions and units of mutual funds (MFs). The segment is characterized by few large investors and a high average trade value. The principal participants are banks, corporate and mutual funds.

(b) The ***capital market (CM) segment***, which covers trading in equities, commenced trading on November 4, 1994 and has been witnessing a substantial growth over the years. NSE adopted the order-driven trading system as opposed to a quote-driven system as it helped reduce jobbing spreads to cut down transaction costs. With the increase in volumes, efficient and transparent trading platform, a wide range of securities like equity, preference shares, debt warrants, exchange traded funds as well as retail government securities, NSE upholds its position as the largest stock exchange in the country.

(c) ***Futures & Options (F&O)*** segment of NSE provides trading in derivatives instruments like Index Futures, Index Options, Stock Options and Stock Futures. The derivative trading at NSE commenced on June 12, 2000 with futures trading on S&P CNX Nifty Index and is now making a mark for itself globally. Since its inception, NSE established itself as the sole market leader in this segment in the country and during 2008-09, it accounted for 99% of the share market.

(d) ***Currency Derivatives Segment (CDS)*** at NSE commenced operations on August 29, 2008, with the launch of Currency futures trading in US Dollar-Indian Rupee (USD-INR). NSE was the first exchange to have received an in-principal approval from SEBI for setting up currency derivative segment and also the first exchange to launch Currency futures trading in India. A total number of 518 trading members which includes 22 banks have taken membership in this market segment as at end March 2009.

- **Settlement of Securities**

The NSE clears and settles its securities according to a periodic settlement cycle. The settlement cycle is completed within eight days from the last day of the trading cycle. The trading period is a week with trading period begins on Wednesday and ends on Tuesday and in the following week settlement is made. For all outstations, the NSE is the only stock exchange for inter-bank securities. It also enters into government securities, treasury bills, public sector bonds and units. The settlement on the Retail Debt Market is on T+2 rolling basis. Clearing and Settlement is based on netting of the trades in a day. The exchange offers clearing and settlement services through its wholly-owned unit, the National Securities Clearing Corporation Ltd. (NSCCL), set up in 1995. The other main subsidiaries/ associate companies of NSE include the National Commodity Clearing, National Securities Depository (which is the repository of all securities in electronic form), and National Commodity and Derivatives Exchange.

- **Nation Wide Trading**

NSE was the first stock exchange in the country set up as a national exchange having nation-wide access with fully automated screen based trading system. Today, NSE has become the largest exchange in India with approximately 67% of the trading volumes on it. It is one of the very few exchanges in the world to also have adopted anonymous order matching system. The member punches in the National Exchange for Automated Trading (NEAT) system, the details of his order such as the quantities and prices of securities at which he desires to transact. The transactions are executed as soon as it finds a matching sale or buy order from a country party. All the orders are electronically matched on a price/time priority basis. It has resulted in a considerable reduction in time spent, cost and risk of error, as well as frauds, resulting in improved operational efficiency. It allows for faster incorporation of price sensitive information into prevailing prices, as the market participants can see the full market on real time basis.

4.4.4 OVER THE COUNTER EXCHANGE OF INDIA (OCTEI)

The Over the Counter Exchange of India (OTCEI) was incorporated under Section 25 of the Companies Act in October 1990 and started functioning from September 1992. OTCEI has been set up to meet a long felt need for a second tier market where companies with small paid—up capital and with less onerous conditions could have the advantage of listing.

Modeled along the lines of the NASDAQ market of USA, OTCEI introduced many novel concepts to the Indian capital markets such as screen-based nationwide trading, sponsorship of companies, market marking, and scripless trading. With this end in view, OTCEI was promoted by the leading financial institutions of the country, namely Unit Trust of India, ICICI, Industrial Development Bank of India, SBI Capital Markets Limited, Industrial Finance Corporation of India, Life Insurance Corporation of India, Canbank Financial Services Limited, and General Insurance Corporation of India and its subsidiaries. NSCCL and NSDL provide clearinghouse facility to OTCEI. Companies listed on the OTC Exchange enjoy the same status as companies listed on any other stock exchange in the country as regards taxes and interest on borrowings. In October 1992, a computerized trading system called Automated Securities Trading over the Computer System (ASTOCS) was installed. OTCEI is now nation-wide and operates from more than 400 cities in India through the nation-wide information dissemination network, *Intext*.

- **Objectives of OTCEI**

OTCEI arouse out of the need to have a second tier market in the country. OTCEI has been established to help small investors who face the problem of access, liquidity, delays in payment and delivery and uncertainty about prices at which shares are bought and sold, and companies who face the problem of prohibitive issue costs and restricted access to the market. It was set up to provide small and medium companies an access to capital market for raising finance in a cost-effective manner and investors in a convenient, transparent, and efficient avenue for capital market investment.

- **Participants of OTCEI**

The market constituents of Over the Counter Exchange of India (OTCEI) are companies, investors, members and licensed dealers. Members and dealers both engage in voluntary market making (VMM) and additional market making but dealers caanot act as sponsors. A member of the OTCEI should have a good organizational set up. The members may be merchant bankers approved by SEBI, mutual funds, banking and financial institutions. A dealer should be an individual, a firm or a corporate body with a net worth of Rs. 5 lakhs and sound capital packing. Members have to pay non-refundable fees of Rs. 20 lakhs and annual subscription of Rs. 1 lakh. Dealers have to pay Rs. 6 lakhs on admission and Rs. 5000 yearly.

- **Market Maker**

Market makers are merchant bankers willing to make a market in securities by continuously offering buy and sell quotes. They act as dealer-cum-stockist and do not change any commission or brokerage. Their profit margin is the spread between the bid and offer prices. A voluntary market maker can be appointed for a period of six months. Market making is a unique concept of OTCEI. The market makers generate investor's interest by quoting the buying and selling rates and creating a competitive environment.

- **Listing on the OTC Exchange**

SEBI guidelines (1992) on public issues envisage listing of securities on any stock exchange or OTCEI. Listing on OTCEI may be sought by companies with equity capital of less than Rs. 10 crores, closely hold companies wanting to attain listed company status and companies assisted by venture capitalists. The listing procedure for OTCEI involves where all quotes and transactions are recorded in the central OTC computer, which can be accessed by any dealer's computer, through telephone lines with modems. The PTI OTC Scan at each dealer's counter will continuously display the best buy and sell quotes offered by market makers, as also all market related information. The Listing requirement of OTCEI is as following:

1. The minimum issued share capital of a company must be Rs. 30 lakhs.
2. For companies with an issued capital of more than Rs. 30 lakhs but less than Rs. 300 lakhs, the minimum public offer should be 25 percent of the issued capital or Rs. 20 lakhs worth of shares (face value) whichever is higher.
3. Companies with an issued capital of more than Rs. 300 lakhs seeking listing on the OTC will have to comply with the listing requirements and guidelines as are applicable to such companies for enlistment on other recognized stock exchanges.

- **Trading Mechanism**

The trading documents on OTCEI are Counter Receipts (CRs), permanent and temporary CRs, sale confirmation slip (SCS), application acknowledges slip, and transfer deed. The counter receipt (CR) is issued to an investor who purchases scrip. The CR is tradable and contains all the information which appears on a share certificate. Four copies of CR were prepared and sent to the investor's counter, OTCEI, registrar, and investor. The counter receipt could be exchanged for share certificate at any of the counters of OTCEI. If the investor wanted to sell these shares on OTCEI, he had just to surrender the permanent counter receipt and transfer deed at the exchange and get a sale confirmation slip. Payment will be made to an investor against the sales confirmation slip. To do trading in OTCEI, an investor walks up to OTC counter, sees price on OTC scan and decides to buy/sell by following the procedures.

Settlement

OTCEI has an online trading-cum-depository, quote-driven and transparent system of trading. It follows T+3 settlement system, which is the fastest in the country. It provides a liquid cash market for the retail investors. The existence of market makers and the modern trading and settlement system on it ensures deliveries versus payment on time. There are no problems of bad deliveries or short deliveries because the system allows the execution of trades only on the basis of electronic inventory of scrips. The trading on OTCEI is based on the roll-over concept which means all trading done on any day is settled on the same day itself, and the netting with the previous or subsequent day's transaction is not permitted. The physical deliveries are consolidated and done once in five days or week. Thus, OTCEI is a cash and retail market for small investors and small companies.

4.4.5 The Inter-Connected Stock Exchange of India (ISE)

Inter-connected Stock Exchange of India Limited (ISE) is a national-level stock exchange and is promoted by 15 Stock Exchanges in India. It was set up as a trading facility at regional stock market inter connected with the national market. ISE provides protection and support required for trading, clearance, settlement and risk management.

- **Objectives of ISE**

The Interconnected Stock Exchange of India was established with the following objectives:

1. Create a single integrated national-level solution with access to multiple markets by providing high cost-effective service to investors across the country.
2. Create a liquid and vibrant national-level market for all listed companies in general and small capital companies in particular.
3. Optimally utilizing the existing infrastructure and other resources of Participating Stock Exchanges, which are under-utilized now.
4. Provide a level playing field to small Trading Members by offering opportunity to participate in a national market for investment-oriented business.
5. Provide clearing and settlement facilities to the Trading Members across the country at their doorstep in a decentralized mode.
6. Spreading demat trading across the country.

- **Inter-Connectivity:**

Inter-connectivity of Stock Exchanges is a mechanism to enable a trader member broker of any Participating Exchange or a Dealer Trading member who is directly enrolled by ISE to deal with another Trader or Dealer through his own Local Trader Work Station. All trading members have to satisfy the capital adequacy requirements of ISE separate from the requirements of their regional stock exchange.

- **Clearing:**

ISE has appointed ABN-Amro Bank and Vysya Bank as the Central Clearing Bank to ensure that all collection and movement of funds is centralized. The margin in the inter-connected market would be collected by directly debiting the accounts of the Traders or Dealers in the Central Clearing bank. This account at the Central Clearing Bank acts as a control account for monitoring margin collection and risk management. The funds collected during the settlement are adjusted during pay-in and pay-out of that settlement.

- **Listing:**

Only listed security can be traded on the stock exchange. The listing agreement between a company and SEBI has to be filled by providing disclosure of information and payment of listing fees. The security can be traded at all the stock markets which are inter-connected ones it is listed on a regional stock market.

4.4.6 SME Exchange:

SME exchange means a trading platform of a recognised stock exchange having nationwide trading terminals permitted by SEBI to list the specified securities issued in accordance with SEBI (ICDR) Regulation and includes stock exchange granted recognition for this purpose but does not include the Main Board. Here Main Board means a recognized stock exchange having nationwide trading terminals, other than SME exchange.

The two stock exchange of India i.e. Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) have begun their SME listing platforms. While BSE SME Exchange began its operation in March, 2012, NSE's SME exchange titled EMERGE commenced operations in September, 2012.

- **Benefits of Listing on SME Exchange**

1. Access to capital and future financing opportunities

   Going public would provide the MSME's with equity financing opportunities to grow their business – from expansion of operations to acquisitions.

2. Companies in the growth phase tend to get over-leveraged at which point, banks are reluctant to provide further credit. Equity capital is then necessary to bring back strength to the balance sheet. The option of equity financing through the equity market allows the firm to not only raise long-term capital but also get further credit due through an additional equity infusion. The issuance of public shares expands the investor base, and this in turn will help set the stage for secondary equity financings, including private placements.

3. In addition, Issuers often receive more favourable lending terms when borrowing from financial institutions. The mechanics of listing on a stock exchange (audited balance sheets, being subject to corporate governance norms etc) would address many of the transparency and informational asymmetry constraints that the financial institutions face in lending to the SME sector. In addition, equity

financing lowers the debt burden leading to lower financing costs and healthier balance sheets for the firms. The continuing requirement for adhering to the stock market rules for the issuers lower the on-going information and monitoring costs for the banks.

4. Increased visibility and prestige going public is likely to enhance the company's visibility. Greater public awareness gained through media coverage, publicly filed documents and coverage of stock by sector investment analysts can provide the SME with greater profile and credibility. This can result in a more diversified group of investors, which may increase the demand for that company's shares leading to an increase in the company's value.

4.5 Membership Rules in a Stock Exchange

In a stock exchange the contract can be made only by brokers or other registered members of the stock exchange. To become a member of the stock exchange, a person has to confirm to certain rules and regulations specified under the Securities Exchange Board of India.

- **Eligibility of Members:**

The eligibility norms for membership provide the following criteria who cannot be members:

- No person shall be eligible to be elected as a member if he is less than 21 years of age.
- A person cannot be a member is he is not an India citizen.
- Adjudged bankrupt or proved to be insolvent or has compounded with his creditors.
- Convicted of an office involving fraud or dishonesty.
- Engaged as principal or employee in any business other than that of securities.
- Member of any other association in India where dealings in securities are carried on.
- Director or employee of company whose principal business is that of dealing in securities.
- Lastly, firms and companies are not eligible for mambership of a recognized stock exchange and individuals are ordinarily not deemed to be qualified unless they have at least two years’ market experience as an apprentice or as a partner or authorized assistant or authorized clerk or their remisiers.

- **Rights of Members**

The SEBI provides the following rights of the registered members of stock exchanges:

Members of the Exchange are entitled to work either as individual entities, or in partnership, or as representative members transacting business on the floor of the market not in their own name but in the name of the appointing members who assume the market responsibility for the business so transacted. The formation of partnership and appointment of representative members is subject to the approval of the Governing Body.

Members are entitled to appoint attroneys to supervise their stock exchange business. Such persons must satisfy in all respects the conditions of eligibility prescribed for membership of the Exchange and their appointment must be approved by the Governing Body.

Active members are also entitled to appoint authorized assistants or clerks to enter into bargains in the markey on their behalf and to introduce clientele business. Remisiers to bring in customers' business may also be appointed.

Registered members are given entry to the floor of the exchange and remunerated with a share of brokerage but they are not permitted to transact any business except through the appointed members or their authorized assistants or clerks. But their appointments as well as of authorized assistants and clerks are subject to the approval of the Governing Body.

The Governing Body of a recognized Stock Exchange has wide government and administrative powers. It has the power, subject to government approval, to make, amend and suspend the operation of the rule, by-laws and regulations of the Exchange. It also has complete jurisdiction over all members and in practice, its power of management and control are almost absolute.

- **Rules for Members**

A member of the stock exchange must have the necessary infrastructure, manpower and experience to conduct the business of purchasing and selling securities. He has to work under the rules, regulations and bye-laws of the different stock exchanges. SEBI exerts control over the members through the various rules and regulations and inspection of records and premises.

Registration of brokers: Every broker has to be registered by paying fees and forwarding an application to the SEBI through the stock exchange where he wants to become a member. He has to maintain a high standard of integrity and protect the interest of the investor by making prompt deliveries and payments.

- ***Maintenance of records:*** he has to maintain a record of his dealings through book of accounts such as Journal, ledger, cash book, bank pass book, contract notes to clients and details of contracts. These books should be maintained and a record of 5 years should be preserved.
- ***Penalty:*** If a member fails to comply with the conditions of registration his membership can be cancelled or he may be penalized by the SEBI. SEBI is also

empowered to inspect the books of members and in the interest of investors attend to any complaints made by them about a stock broker through investigations and audit of documents and organizational activities.

- ***Capital Adequacy Norms:*** SEBI has also brought about control overmembers by insisting on capital adequacy norms. A member is required to have a lease capital and an additional capital which is related to the value of business. The base or minimum capital required by Mumbai and Kolkata Stock Exchanges is Rs. 5 lakhs. Ahmedabad and Delhi Stock Exchanges require a minimum of Rs. 3.5 lakhs from members. Other stock exchanges require Rs. 2 lakhs as a minimum deposit. One-fourth of the minimum requirements is to be maintained by the brokers in cash with the stock exchange. 25% is to be maintained as a long-term fixed deposit with a bank with a lien of the stock exchange. The rest of the 50% is to be maintained in the form of securities with a margin of at least 30%. The gross outstanding business should not be more than 12.5 times of the combined base and additional capital. For any additional business there should be additional capital. As a rule, there should not be less than 8% of the gross outstanding business of the broker. The member's capital is calculated by taking into account all his assets minus non-allowable assets. A member or broker must maintain separate accounts for himself and his clients but the broker can claim his charges from his client.
- ***Code of Conduct:*** SEBI insists that stock brokers (members) of the stock exchange should maintain a code of conduct in their dealings with other brokers of the same stock exchange. In the interest of the investors he should be disciplined and should not make false statements to fellow brokers as it is likely to jeopardise the interest of the investors.
- **Types of Members**

Functionaries of the stock exchanges refer to those persons or individuals or institutions who perform the functions of a stock exchange and who are the registered members of the exchange. The following are the various types of functionaries who function at the stock exchange:

(1) Jobbers

Jobbers are security merchants dealing in shares and debentures as independent operators. They buy and sell securities on their own behalf and try to earn through price changes. Jobbers cannot deal on behalf of public and are barred from taking commisssion. They directly deal with brokers who in turn make transactions on behalf of public. Jobber generally quotes two prices, one at which he is prepared to purchase and the other at which he is prepared to sell a particular security. The difference between the two prices is the Jobber's profit which is technically known as Jobber's turn. The London Stock Exchange has two tyoes of members known as Jobbers and brokers. Every members has to declare in the beginning every year whether he will be acting as Jobber or Broker. Once he makes a declaration then he has to stick to it.

Characteristics of Jobbers:

1. A jobber purchases and sells securities in his own account and has no contact with the general public.
2. The jobber does not work on commission basis, rather he works for profit.
3. A Jobber always quotes two prices ─ one high and one low ─ while dealing with brokers and aims at earning profit out of the differences between two prices.
4. A jobber is a professional speculator. He specifies in a limited number of securities.

(2) Brokers

Brokers are commission agents, who act as intermediaries between buyers and sellers of securities. They do not purchase or sell securities on their behalf. They bring together buyers and sellers and help them in making a deal. Brokers charge commission from both the parties for their services. Brokers are the experts in estimating trends of prices and can effectively advise their client in reaching a fruitful gain. Brokers get orders from investing public and execute the orders through Jobbers and they are entitled to a prescribed scale of brokerage. The investors who do not know the technalities of stock exchanges are greatly benefited by the expertise of brokers.

A broker has to make an application for registration as a member of stock exchange to SEBI along with the requisite fee. The Board after satisfying itself that the applicant has the necessary infrastructure to effectively carry out its activities will grant the certificate of registration. The broker has to take adequate measures for redressal of grievances of investors within 30 days from the date of receiving complaint and has to inform SEBI about such complaints. Once registered, the brokers have to follow a specified code of conduct.

➢ ***Duties of a Broker:***

The duties of a broker can be divided into following three main groups:

(a) General duties (b) Duty to the Investors (c) Duties towards other stock brokers.

(a) General Duties

(1) *Integrity:* A stock-broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.

(2) *Exercise of due skill and care:* A stock-broker shall act with due skill, care and diligence in the conduct of all his business.

(3) *Manipulation:* A stock broker shall not indulge in manipulative, fradulent or deceptive transactions or schemes or spread rumours with a view to distorting market equilibrium or making personal gains.

(4) *Malpractices:* A stock-broker shall not create false market either singly or in concert with others or indulge in any detrimental to the investor's interest or which leads to interference with the fair and smooth functioning of the market. A stock-broker shall not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness.

(5) *Compliance with statutory requirements:* A sub-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.

(b) Duty to the Investors.

(1) *Execution of Orders:* a stock-broker, in his dealings with the clients and the general investing public, shall faithfully execute the orders for buying and selling of securities at the best available market price and not refuse to deal with a small investor merely on the ground of the volume of business involved. A stock-broker shall promptly inform his client about the execution or non-execution of an order, and make prompt payment in respect of securities sold and arrange for prompt delivery of securities purchased by clients.

(2) *Issue of Contract Note:* A stock-broker shall issue without delay his client a contract note for all transactions in the form specified by the stock exchange.

(3) *Breach of Trust:* A stock-broker shall not disclose or discuss with any other person or make improper use of the details of personal investments and other information of a confidential nature of the client which he comes to know in his business relationship.

(4) Business and Commission:

(a) A stock-broker shall not encourage sales or purchases of securities with the sole object of generating brokerage or commission.

(b) A stock-broker shall not furnish false or misleading quotations or give any other false or misleading advise or information to the clients with a view of inducing him to do business in particular securities and enabling himself to earn brokerage or commission thereby.

(5) *Business of defaulting clients:* A stock-broker shall not deal or transact business knowingly, directly or indirectly or execute an order for a client who has failed to carry out his commitments in relation to securities with another stock-broker.

(6) *Fairness to clients:* a stock-broker, when dealing with a client, shall disclose whether he is acting as a principal or as agent and shall ensure at the same time, that no confliect of interest arises between him and the client. In the event of a conflict of interest, he shall inform the client accordingly and shall not seek to gain a direct or indirect personal advantage from the situation and shall not consider clients' interest inferior to his own.

(7) *Investment Advice:* a stock-broker shall not make a recommendation at any client who might be expected to rely thereon to acquire, dispose of, retain any securities unless he has reasonable grounds for believing that the recommendation is suitable for such a client upon the basis of the facts, if disclosed by such a client as to his own security holdings, financial situation and objectives of such investment. The stock-broker should seek such information from clients, whereverhe feels it is appripriate to do so.

(8) Investment Advice in Publicly Accessible Media:

(a) A stock broker or any of his employees shall not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of his interest including the interest of his dependent family members and the employer including their long or short position in the said security has been made, while rendering such advice.

(b) In case, an employee of the stock broker is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

(9) *Competence of Stock-Broker:* A stock-broker should have adequately trained staff and arrangements to render fair, prompt and competence services to his clients.

(c) Duties towards other sub-brokers and stock-brokers.

(1) *Conduct of Dealings:* A stock-broker shall co-operate with the other contracting party in comparing unmatched transactions. A stock-broker shall not knowingly and wilfully deliver documents which constitute bad delivery and shall cooperate with other contracting party for prompt replacement which are declared as bad devivery.

(2) *Protection of Clients Interests:* A stock-broker shall extend fullest co-operation to other stock-brokers in protecting the interests of his clients regarding tehir rights to dividends, bonus shares, right shares and any other right related to such securities.

(3) *Transactions with Stock-Brokers:* A stock-broker shall carry out his transactions with other stock-brokers and shall comply with his obligations in completing the settlement of transactions with them.

(4) *Advertisement and Publicity:* A stock-broker shall not advertise his business publicly unless permitted by the stock exchange.

(5) *Inducement of Clients:* A stock-broker shall not resort to unfair means of inducing clients from other stock-brokers.

(6) *False or Misleading Returns:* A stock-broker shall not neglect or fail or refuse to submit the required returns and not make any false or misleading statement on any returns required to be submitted to the Board and the stock exchange.

- **General Obligations and Responsibilities:**

  (1) Every stock broker should keep and maintain register of transations, clients ledger, general ledger, journals, cash book, bank pass book, member's contracts books etc. for a minimum period of 5 years.

  (2) Every stock broker shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the Central Government and for redressal of investor's grievances.

  (3) The stock broker shall furnish such books, accounts and other documents in his custody and furnish him with the statements and information rlating to securities market, to the inspection authority.

- **Suspension or Cancellation:**

SEBI has the power to suspend or cancel rehistration and impose penalties to a broker, if he:

(i) is found to be indulging in manipulations and rigging of prices;

(ii) violates any of the provisions of the SCRA and the Regulations.

(3) **Sub-broker**

A sub-broker is an agent of the stock broker or a person who helps the investors to deal with stock broker. A stock broker may allow a sub-broker to act on his behalf for helping the investor in purchase or sale of securities but sub-brokers are not members of the stock exchange. A sub-broker has to pay a fee, get a recommendation letter from a broker on whose behalf he wants to act in the stock exchange. He has to pay a fee of one thousand rupees a year for 5 years to continue his registration. After 5 years his fees will be five hundred every year. The rules applying to a stock broker also apply to a sub-broker. A sub-broker should protect the interest of the investor and maintain books of account and carry out all the legal requirement of the stock exchange. He should extent co-operation to the broker and also see that the necessary facilities and rights of investors are duly protected relating to issues of rights shares, bonus issues and dividends. To maintain a relationship with the broker he should draw out an agreement with him specifying his rights and liabilities and also that of the main broker on whose behalf he is carrying on the transactions.

(4) Tarawaniwalas

The members of Bombay Stock Exchange have unofficially divided themselves into two categories: (i) Brokers and (ii) Tarawaniwalas. The latter acts both as jobber and broker. A tarawaniwala makes transactions on his own behalf like a Jobber but he may also act as a broker on behalf of the public. They indulge in malpractices to earn practices. They may sell their own securities to their clients when prices are higher and vice-versa.

The distinction between Jobbers of London Exchange and Tarawaniwalas of Bombay Stock Exchange is that the former are not brokers whereas the latter may act as brokers and jobbers. Section 15 of the Securities Contract (Regulation) Act prohibits such practices. It states that no member of a recognized stock exchange shall, in respect if any securities, enter into any contract as a principal with any person other than a member of a recognized stock exchange, unless he has secured the consent or authority of such person and discloses in the memorandum or agreement of sale or purchase that he is acting as principal.

(5) Portfolio Consultants

Portfolio construction, formulation of investment strategy, evaluation and regukar monitoring of portfolio is an art and requires skill and high degree of expertise. Portfolio consultants possess the requisite skill and experience. They advise their clients or direct them or direct them or undertake investments on behalf of their clients and manage the same. A person is allowed to act as portfolio consultant only if he possesses a certificate granted by SEBI. Every portfolio consultant has to deposit a fee of Rs. 5 lakh as registration fees at the same time of the grant of certificate by the Board. After three years he has to pay a renewal fee of Rs. 2.5 lakhs. The certificate of registration or its renewal is valid for a period of three years from the date of its issue to the portfolio manager. Failure to pay fees in the prescribed time will lead to suspension of certificate.

4.6 Summary

Since 1992, several changes have taken place in the area of secondary market. First, relative importance of exchanges has changed as BSE is no longer the premier exchange of India and NSE occupies the dominant poisiton. Also, the position of various RSEs are not good and might disappear in the coming years. The various rules and regulations have been changed and improved by SEBI to combat the evils of wrong practices of the stock brokers and other functionaries. Up to certain extent this problem has been solved, but there is still a long way to go for the regulatory authorities to match the advancement of the developed stock markets of foreign countries.

4.7 Self Assessment Questions

1. What do you mean by a Stock Exchange? Discuss its various characteristics and various fuctions of a stock exchange.
2. Discuss in detail the organization, growth and weaknesses of stock exchanges in India.
3. What is the role of SEBI in a stock exchange?
4. Describe some of the major stock exchanges in India. How is OTCEI different from other stock exchanges?
5. What is the procedure followed at the various stock exchanges for making purchases and sales?
6. How is security traded on Bombay Stock Exchange, National Stock Exchange and Over the Counter Exchange of India?
7. Write short notes on:
   (a) Inter-connected stock exchange of India.(b) BOLT(c) Buy back of shares.(d) Venture Capital.

4.8 Reference Books

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Unit : 5 - Trading Mechanism of Stock Exchanges

Structure of Unit:

5.0 Objectives

After completing this unit, you would be able to understand:

- Trading and trading cycle
- Classification of types of trading.
- Classification of Trading Mechanism
- About Clearing and Settlement
- The mechanism of Electronic and Paperless trading.
- Safety and Security of electronic Trading System.

5.1 Introduction

Stock exchange is taken as a Barometer of the economy of a country. It is the most dynamic and organised component of capital market. Especially, in developing countries like India, the stock exchanges play a cardinal role in promoting the level of capital formation through effective mobilisation of savings and ensuring investment safety. It is equally important to have the understanding of the governance of Stock Exchanges, and the services they provide to investors. SEBI has been consistently making an effort to promote secondary market which is both efficient and fair and also on the other hand protects the rights of investors. Automation of secondary market infrastructure improves market transparency, and improvement of market micro-structure increases trading efficiency. Risk containment in secondary market tends to measures and improves market integrity and credibility time to time. SEBI has directed its efforts towards encouraging the stock exchanges to become effective self regulatory and self controlled body by war of issuing guidelines in Security Control Regulation Act.

5.2 Trading-Defined

Stock exchanges represent the market place for buying and selling of securities and ensuring liquidity to them in the interest of the investors. The stock exchanges are virtually the nerve centre of the capital market and reflect the health of the country's economy as a whole. Securities are traded in three different ways in stock exchanges ring, namely–settlement basis, spot basis and cash basis.

Shares of companies which are not in the spot list are known as 'cash' shares or 'B' Category shares. They are traded on cash basis or delivery basis and cannot be traded on settlement basis. The actual delivery of securities and payment has to be made on or before the settlement date fixed in the case of cash basis trading.

As far as spot trading is concerned the actual delivery of securities must be made to the buying broker within 48 hours of the contract. It is expected that the seller would be paid by the buyer immediately on delivery of securities. All securities whether the specified list or cash list can be traded on spot basis or cash basis.

- **Types of Securities-**Securities traded in the stock exchanges can be classified as under:

(1) Listed cleared Securities: The securities admitted for dealing on stock exchange after complying with all the listing requirements and played by the Board on the list of cleared securities are called by this name.

(2) Permitted Securities: The securities listed on some of the recognised stock exchanges, when permitted to be traded by those stock exchanges where they are not listed are called permitted securities. Such permission is given if suitable provisions exist in the regulations of the concerned stock exchanges.

- **Margin Trading-**Margin trading was introduced by SEBI to curb speculative dealings in shares leading to volatility in the prices of securities. "Initial margin" in this context means the minimum amount, calculated as a percentage of the transaction value, to be placed by the client, with the broker, before the actual purchase. The broker may advance the balance amount to meet full settlement obligations. "Maintenance margin"means the minimum amount, calculated as a percentage of market value of the securities, calculated with respect to last trading day's closing price, to be maintained by client with the broker. When the balance deposit in the client's margin account falls below the required maintenance margin, the broker shall promptly make margin calls. However, no further exposure can be granted to the client on the basis of any increase in the market value of the securities.
- **Book Closure and Record Date-**Book closure is the periodic closure of the Register of Members and Transfer Books of the company, to take a record of the shareholders to determine their entitlement to dividends or to bonus or right shares or any other rights pertaining to shares. Record date is the date on which the records of a company are closed for the purpose of determining the stock holders to whom dividends,

proxies rights etc. are to be sent. In accordance with Section 154 of the Companies Act, 1956 a company may close the register of members for a maximum of 45 days in a year and for not more than 30 days at any one time. Book closure become necessary for the purpose of paying dividend, making rights issue or bonus issue. The listed company is required to give notice of book closure in a news paper at least 7 days before the commencement of the book closure. The members whose names appear in the register of members on the last date of book closure are entitled to receive the benefits of dividend, right shares or bonus shares as the case may be.

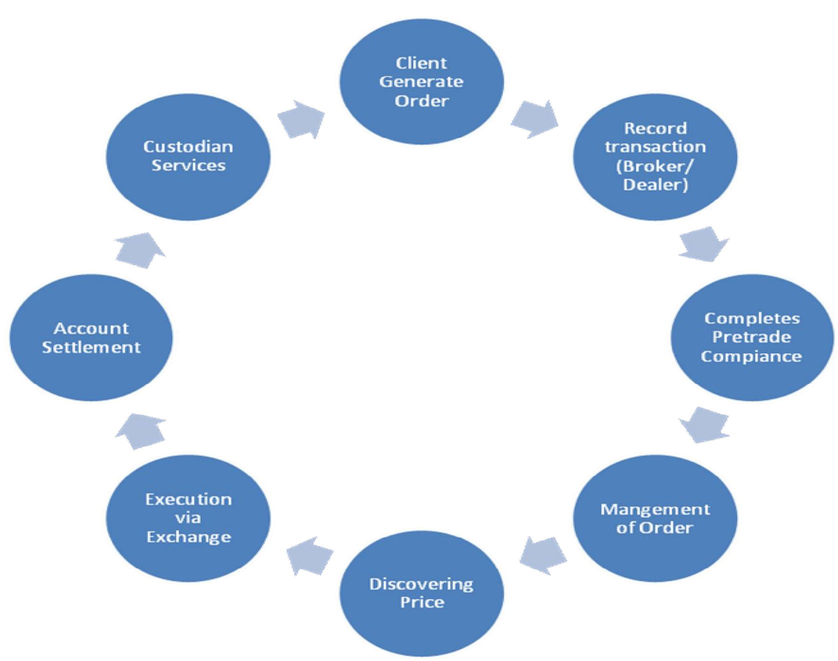
- **Trading of Partly Paid Shares and Debentures-**Companies fix the last date for payment of allotment or call money in case of partly paid shares or debentures and intimate this to all the stock exchanges wherein such shares or debentures are listed. Based on the date fixed by the company, the stock exchanges determine the settlement date upto which transactions in the scrip will be deemed to be good for delivery. After the said date, transactions in the securities take place only if they are paid up to the extent money has been called up.
- **Trend Line-**When the price of shares moves in a particular direction which persists for a period of time, a price line is regarded as established. When the movement is upward, the trend is called 'BULLISH' and when the movement is downward it is called 'BEARISH'. Bear market is a weak or falling market characterised by the dominance of sellers. Whereas Bull market is a rising market with abundance of buyers and relatively few sellers. Secondary movements that reverse the uptrend temporarily are known as reactions. The movements that reverse the down trend temporarily are known as rallies. When an uptrend breaks in the downward direction, it is called trend reversal.
- **Trading Cycle-** The trades accumulated over a prescribed trading cycle and at the end of the cycle, these were clubbed together for settlement. The positions were netted out and payment of cash and delivery of securities settled the balance on a delivery price as agreed by the parties. This trading cycle in the exchange varied from 14 days for specified securities to 30 days for others and settlement took another fortnight. Often this cycle was not adhered to physical delivery. Many things could happen between entering into a trade and its performance providing incentives for either of the parties to go back on its promise. This had on several occasions led to defaults and risks in settlement done by the counterparties to trade. In order to reduce large open positions and the risk of losses, the trading cycle was reduced over a period of time to a week. The exchanges, however, continued to have different weekly trading cycles, which enabled shifting of positions from one exchange to another. Rolling settlement on T+5 (Trading Week) basis was introduced in respect of specified scrips reducing the trading cycle to one day. It was made mandatory for all exchanges to follow a uniform weekly trading cycle in respect of scrips not under rolling settlement. All scrips moved to rolling settlement from December 2001. T+5 gave way to T+3 (trading on third day) from April 2002 and T+2 (trading on second day) since April 2003. The market also had a variety of deferral products like

modified carry forward system, which encouraged leveraged trading by enabling postponement of settlement. The deferral products have been banned. The market has moved close to spot/cash market. Presently T+1 settlement are more prominent as the players in the market are arbitraging and deriving benefits out of intra- day trade.

5.2.1 Derivatives Trading

To assist market participants to manage risks better through hedging, speculation and arbitrage, Securities Contract (Regulation) Act was amended in 1995 to lift the ban on options in securities. However, trading in derivatives did not take off, as there was no suitable legal and regulatory framework to govern these trades. Besides, it needed a lot of preparatory work- the underlying cash markets strengthened with the assistance of the automation of trading and of the settlement system; the exchanges developed adequate infrastructure and the information systems required to implement trading discipline in derivative instruments. The SC(R) A was amended further in December 1999 to expand the definition of securities to include derivatives so that the whole regulatory framework governing trading of securities could apply to trading of derivatives also. A three-decade old ban on forward trading, which had lost its relevance and was hindering introduction of derivatives trading, was withdrawn and derivatives trading took off in June 2000. The Mini derivative Futures & Options contract was introduced for trading on S&P CNX Nifty on January 1, 2008 while the long term option contracts on S&P CNX Nifty were introduced for trading on March 3, 2008.

Basic Trading Process



5.4 Types of Trading

Broadly trading in shares is done in two ways:-

A: Online Share Trading

Share trading is carried with the help of computer and internet connection using Very Small Aperture Terminal VSAT. The trader has to open trading and demat account with the broker where he can transact shares on his stipulated prices. The broker charge brokerage on both buying and selling of shares.

- **Essentials of Online Share Trading**

Trader has to open an online trading account with any of the bank, Broking firm or financial trading house like SBI, ICICI Direct, Anand Rathi & Sherkhan etc. There will be nominal annual charges by these broking firms for providing these services. Computer with internet connection is required but nowadays some people do trading on mobile. Nowadays computers are easily affordable and to ensure consistency on can use UPS as power backup. Upgraded technologies in mobile phones have made it possible to trade stocks any day any time during the stock market working hours.

After successfully opening the online trading account you will receive the username and password with the help of which you can login in online trading system and trade yourself. The executive of broker (with whom you opened trading account) will help you initially about how to use the online trading system and manage your portfolio.

- **Benefits of online Share Trading**
  - It reduces dependability on broker or anyone else as you have access to trading terminal any time during working hour.
  - It’s reliable, convenient and trader can take his own decisions himself by seeing or analyzing the market all the time.
  - Easy price discovery and buying and selling on CMP are possible for trader. So if you are doing on line trading yourself, then you may save yourself from huge losses by booking profit or by coming out of the stock.
  - Easy access to news and updates on various websites and also on your on line trading system and most of the information will be free of cost.
  - By doing on line trading yourself, you can see and judge where market (or your share) is heading by seeing different graphs on line. Some on line trading systems have graphs integrated in their system, so your job is to just add those graphs and check the status of current market (or share) and depending on your analysis you can take steps towards successfully trading.
  - All transactions and related documents can be seen on line and can also be downloaded to your PC without depending on your broker.

B: Offline Share Trading

Traders who do trading with the help of broker or through telephone is called off line share trading. In other words trading will be done by another person or nominee of the company on your behalf based on the instructions given by you. The other person would be a broker or employee of Broking Company. The broker will do buying and selling of shares on your behalf depending on the instructions given by you.

5.5 Trading Mechanism

Earlier the trading on stock exchanges in India used to take place through open outcry without use of information technology for immediate matching or recording of trades. This was very time consuming and inefficient process. This imposed limits on trading volumes and efficiency of trade or deals carried by clients on exchanges. In order to provide efficiency, liquidity and transparency, on line trading system was introduced nation-wide on-line and fully automated screen based trading system (SBTS). Here a member can punch into the computer desired quantities of securities and the current market prices at which he likes to transact and the transaction is executed as soon as it finds a matching sale or buy order from other traders. SBTS electronically matches orders on a strict price/time priority and hence cuts down time, cost and risk of error, as well as on fraud resulting in improved operational efficiency of exchanges. It also allows faster incorporation of price sensitive information into prevailing prices, thus increasing the informational efficiency of markets. It enables market participants to participate in trade, irrespective of their geographical locations and simultaneously improve the depth and liquidity of the market. It also provides full secrecy by accepting orders, big or small, from the trader/client/ members without revealing their identity. It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety.

Innovation in technology was used to carry the trading platform efficiently from the trading hall of stock exchanges to the premises of brokers. Exchanges carried the trading platform further to the PCs at the residence of trader/ client through the Internet and to handle devices through Wireless Application Protocol (WAP) for convenience of mobile investors. This made a huge difference in terms of equal access to investors in a geographically located.

Exchanges has main computer which is connected through Very Small Aperture Terminal (VSAT) installed at its office. The main computer runs on a fault tolerant STRATUS mainframe computer at the Exchange. PC's installed at their premises which are connected through these VSATs/leased lines/modems. An investor informs a broker to place an order on his behalf. The broker enters the order through his PC and sends signal to the Satellite via VSAT/leased line/modem. The signal is directed to mainframe computer at Stock Exchanges via VSAT at Stock Exchanges office. A message relating to the order activity is broadcast to the respective member. The order confirmation message is immediately displayed on the PC of the broker. This order matches with the existing passive order(s) otherwise it waits for the active orders to enter the system. On order matching, a message is broadcast to the respective member.

The trading system of exchanges operates on a strictly on price time priority basis. All the orders received by exchange on the system are sorted on the basis of best priced order quoted by client/ trader at the first priority for matching the deal. This indicates that the best buy orders match with the best sell order. Similar priced orders of the clients are sorted on time priority basis, i.e. the one that is punches in early by the client in the system gets priority over the later one. Orders are matched and traded automatically by the computer of trader and exchange keeping the system transparent, objective and fair for the trade carried during the trading session. If the order does not find the match in prices, it remains in the system and the order is displayed to the whole market, till a fresh order comes in or the earlier order is canceled or modified by the trader/ client. The trading system provides enormous flexibility to the users in terms of kinds of orders that can be placed on the system.

The conditions prevailing in the market are on the basis of time-related (day, immediate or cancel), price-related (buy/sell limit and stop loss orders) or volume related (Disclosed Quantity) order. The trading system also provides complete market information to the trader/ client on-line. The market screen at any point of time provides complete information about the total order depth in a security. The information related to five best buys and sells quotations are available in the market, the quantity traded during the day in that security, the high and the low, the last traded price, etc facilitates investors to take decisions about the stock. Investors can also know the fate of the orders almost as soon as they are placed with the trading members. Thus the exchange system provides an Open Electronic Consolidated Limit Order Book (OECLOB). Limit orders are orders to buy or sell shares at a stated quantity and stated price on the trading day. If the quoted price quantity conditions do not match the market price, the limit order will not be executed in the market. The term ‘limit order book’ can be referred to the fact that only limit orders are stored in the book and all market orders are crossed against the limit orders sitting in the book. Since the order book is visible to all market participants, it is termed as an ‘Open Book’.

5.5.1 Algorithmic Trading

Any order that is generated using automated execution logic shall be known as algorithmic trading. With the increasing trend amongst capital market players of generating orders through automated execution logic called Algorithmic Trading. SEBI have formulated broad guidelines to be followed by both Stock Exchanges and Stock Brokers for Algorithmic Trading. These guidelines permits secure systems for algorithmic trading and help to keep pace with the speed of trade and volume of data that may arise through it.

Broadly the Guidelines provides for following directions to Stock Exchanges amongst others:

- To have arrangements, procedures and systems to adequately manage the trade load of algorithm orders.
- To put in place effective economic disincentives with regard to high daily order to trade ratio of algorithm orders.
- To ensure all trades are routed through servers of stock brokers located in India only.
- To have appropriate risk control mechanisms covering price band check and quantity limit check.
- To report algorithmic trading details in the Monthly Development Report submitted to SEBI.
- To ensure that the stock brokers provide the facility of algorithmic trading only after obtaining prior permission of the stock exchanges.

For Stock Brokers the new Guidelines provides for followings:

- Stock Brokers are directed to implement the minimum levels of risk controls and shall ensure that the algorithm orders are not released in breach of price band check, Quantity limit check, Value per order check.
- Stock Brokers are directed to prescribe individual client level cumulative open order value check.
- To have pre- defined parameters for algorithm systems, for an automatic stoppage if algorithm execution leads to loop or a runaway situation.
- To tag algorithm orders with a unique identifier which is provided by the Stock Exchanges to establish audit trail.
- To include a specific report ensuring that the checks are in place in the annual system audit report submitted by the Stock Brokers to Stock Exchanges.
- Stock brokers interesting in Algorithmic Trading are required to submit to Stock exchanges undertakings w.r.t. having proper procedures, systems and technical capability to carry such trades, safeguards to protect any misuse, real time monitoring system and logs of all trading to facilitate audit trail etc.

5.6 Process of Clearing & Settlement

5.6.1 Understanding Trade Settlement Cycle

India is one of the most advanced markets when it comes to settlement of trade. The domestic market follows a T+2 settlement cycle. India is one of the most advanced markets when it comes to settlement of trade.

- **Rolling Settlement-**In a rolling settlement, each trading day is considered as a trading period and trades executed during the day are settled based on net obligations for the day. In India, trades in rolling settlement are settled on a T+2 basis i.e. on the 2nd working day after a trade.
- **Days calculated for the Purpose of rolling settlement-**For arriving at the settlement day, all intervening holidays, which include bank holidays, exchange holidays, Saturdays and Sundays, are excluded. Typically, trades taking place on Monday are settled on Wednesday, Tuesday's trades are settled on Thursday and so on.Under rolling settlement, all open positions at the end of the day mandatorily result in payment/ delivery 'n' days later. Currently, trades in rolling settlement are settled on T+2 basis where T is the trade day. For example, a trade executed on Monday is mandatorily settled by Wednesday (considering two working days from the trade day).
- **Settlement Cycle for Rolling Settlement**
  - Activity Day Trading Rolling settlement T
  - Clearing Custodial confirmation and delivery generation T+1 working days
  - Settlement Securities and funds pay-in and pay-out T+2 working days
  - Post settlement Auction T+3 working days
  - Bad delivery reporting T+4 working days
  - Auction settlement T+5 working days
  - Rectified bad delivery pay-in and pay-out T+6 working days
  - Re-bad delivery reporting and pick up T+8 working days
  - Close out of re-bad delivery and funds pay-in and pay-out T+9 working days

For intraday traders, rolling settlement changes nothing. For institutional investors, who are forbidden to square off anyway, there would be no change. It is for retail investors who take leveraged positions across one night or more that rolling settlement has an impact. The funds and securities pay-in and pay-out are carried out on T+2 days

- **Pay–in and Pay-out-P**ay-in day is the day when the securities sold are delivered to the exchange by the sellers and funds for the securities purchased are made available to the exchange by the buyers. Pay-out day is the day the securities purchased are delivered to the buyers and the funds for the securities sold are given to the sellers by the exchange. At present, the pay-in and pay-out happens on the 2nd working day after the trade is executed on the exchange, that is settlement cycle is on T+2 rolling settlement.

- **No-delivery Period-**Whenever a company announces a book closure or record date, the exchange sets up a no-delivery period for that security. During this period only trading is permitted in the security. However, these trades are settled only after the no-delivery period is over. This is done to ensure that investor's entitlement for the corporate benefit is clearly determined.
- **Auction-**On account of non-delivery of securities by the trading member on the pay-in day, securities are put up for auction by the exchange. This ensures that buying trading member receives the securities. The Exchange purchases the requisite quantity in auction market and gives them to the buying trading member.

5.6.2 Bombay Stock Exchange Ltd

- **Trading at BSE-**The scrips traded on BSE have been classified into various groups. BSE has, for the guidance and benefit of the investors, classified the scrips in the Equity Segment into 'A', 'B', 'T', and 'Z' groups on certain qualitative and quantitative parameters. The "F" Group represents the Fixed Income Securities. The "T" Group represents scrips which are settled on a trade-to-trade basis as a surveillance measure. Trading in Government Securities by the retail investors is done under the "G" group.

  The 'Z' group was introduced by BSE in July 1999 and includes companies which have failed to comply with its listing requirements and/or have failed to resolve investor complaints and/or have not made the required arrangements with both the Depositories, viz., Central Depository Services (I) Ltd. (CDSL) and National Securities Depository Ltd. (NSDL) for dematerialization of their securities.

  BSE also provides a facility to the market participants for on-line trading of odd-lot securities in physical form in 'A', 'B', 'T', and 'Z' groups and in rights renunciations in all groups of scrips in the Equity Segment.

  With effect from December 31, 2001, trading in all securities listed in equity in the Equity segment takes place in one market segment, viz., Compulsory Rolling Settlement (CRS) Segment. The scrips of companies which are in demat can be traded in market lot of 1. However, the securities of companies which are still in the physical form are traded in the market lot of generally either 50 or 100. Investors having quantities of securities less than the market lot are required to sell them as "Odd Lots". This facility offers an exit route to investors to dispose of their odd lots of securities, and also provides them an opportunity to consolidate their securities into market lots. This facility of selling physical shares in compulsory demat scrips is called as Exit Route Scheme. This facility can also be used by small investors for selling up to 500 shares in physical form in respect of scrips of companies where trades are required to be compulsorily settled by all investors in demat mode.

- **Computation of Closing Price of Scrips in the Cash Segment-**The closing price of scrips is computed by the Exchange on the basis of weighted average price of all trades executed during the last 30 minutes of the continuous trading session. However, if there is no trade recorded during the last 30 minutes, then the last traded price of scrip in the continuous trading session is taken as the official closing price.

- **Basket Trading System-**The Exchange commenced trading in the Derivatives Segment with effect from June 9, 2000 to enable the investors to, inter-alia, hedge their risks. Initially, the facility of trading in the Derivatives Segment was confined to Index Futures. Subsequently, the Exchange introduced the Index Options and Options & Futures in select individual stocks. The investors in cash market had felt a need to limit their risk exposure in the market to movement in Sensex. With a view to provide investors the facility of creating Sensex linked portfolios and also to create a linkage of market prices of the underlying securities of Sensex in the Cash Segment and Futures on Sensex, the Exchange has provided to the investors as well its member-brokers, a facility of Basket Trading System on BOLT. In the Basket Trading System, the investors through the member-brokers of the Exchange are able to buy/sell all 30 scrips of Sensex in one go in the proportion of their respective weights in the Sensex. The investors need not calculate the quantity of Sensex scrips to be bought or sold for creating Sensex linked portfolios and this function is performed by the system. The investors can also create their own baskets by deleting certain scrips from 30 scrips in the Sensex. Further, the investors can alter the weights of securities in such profiled baskets and enter their own weights. The investors can also select less than 100% weightage to reduce the value of the basket as per their own requirements.

  To participate in this system, the member-brokers need to indicate number of Sensex basket(s) to be bought or sold, where the value of one Sensex basket is arrived at by the system by multiplying `.50 to prevailing Sensex.

  For e.g., if the Sensex is 19,000, then value of one basket of Sensex would be 19000 x 50 = i.e., `9,50,000. The investors can also place orders by entering value of Sensex portfolio to be bought or sold with a minimum value of `50,000/- for each order.

  The Basket Trading System provides the arbitrageurs an opportunity to take advantage of price differences in the underlying Sensex and Futures on the Sensex by simultaneous buying and selling of baskets comprising the Sensex scrips in the Cash Segment and Sensex Futures. This is expected to provide balancing impact on the prices in both cash and futures markets.

  The Basket Trading System, thus, meets the need of investors and also improves the depth in cash and futures markets.

- **Settlement System at BSE**

(i) **Compulsory Rolling Settlement-**All transactions in all groups of securities in the Equity segment and Fixed Income securities listed on BSE are required to be settled on T+2 basis (w.e.f. April 1, 2003). The settlement calendar, which indicates the dates of the various settlement related activities, is drawn by BSE in advance and is circulated among the market participants.

Under rolling settlements, the trades done on a particular day are settled after a given number of business days. A T+2 settlement cycle means that the final settlement of transactions done on T, i.e., trade day by exchange of monies and securities between the buyers and sellers respectively takes place on second business day (excluding Saturdays, Sundays, bank and Exchange trading holidays) after the trade day.

The transactions in securities of companies which have made arrangements for dematerialization of their securities are settled only in demat mode on T+2 on net basis, i.e., buy and sell positions of a member-broker in the same scrip are netted and the net quantity and value is required to be settled. However, transactions in securities of companies, which are in “Z” group or have been placed under “trade-to-trade” by BSE as a surveillance measure (“T”), are settled only on a gross basis and the facility of netting of buy and sell transactions in such scrips is not available.

The transaction in “F” group securities representing “Fixed Income Securities” and “G” group representing Government Securities for retail investors are also settled at BSE on T+2 basis. Thus, the pay-in and pay-out of funds and securities takes places on the second business day (i.e., excluding Saturday, Sundays and bank & Exchange trading holidays) of the day of the execution of the trade. The Information Systems Department of the Exchange generates, inter-alia, the following statements, which can be downloaded by the member-brokers in their back offices on a daily basis.

(a) Statements giving details of the daily transactions entered into by the member-brokers.

(b) Statements giving details of margins payable by the member-brokers in respect of the trades executed by them.

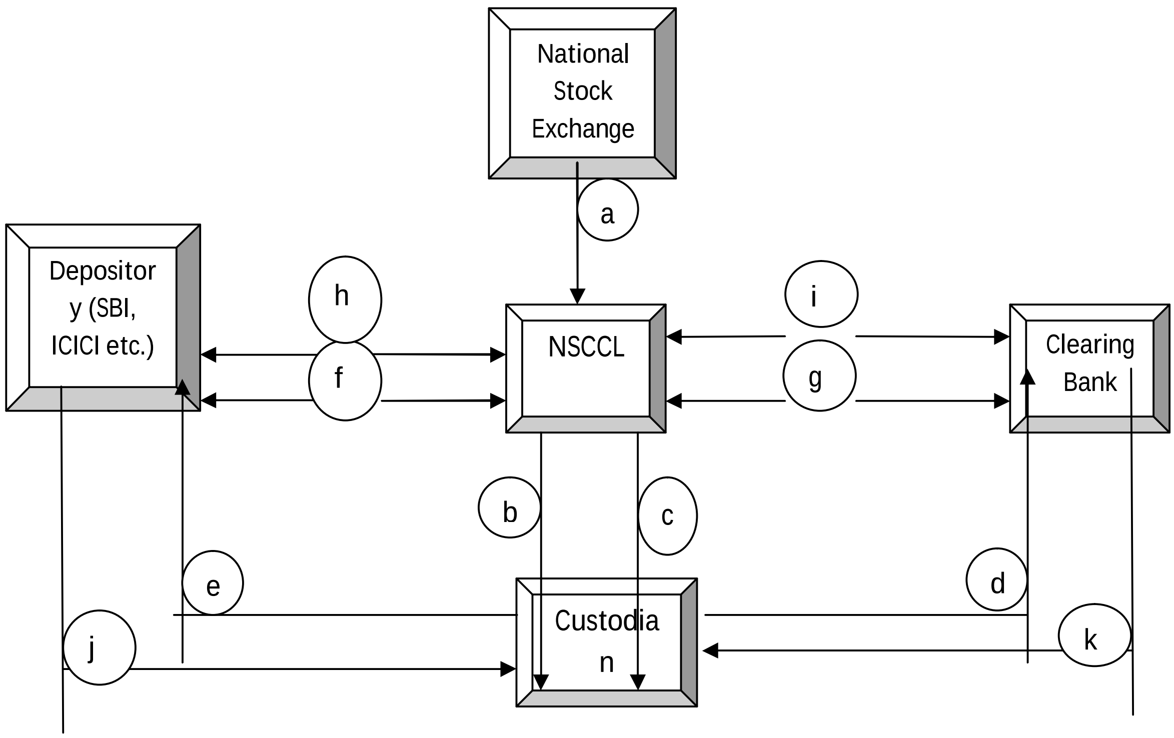
(c) Statements of securities and fund obligation.

(d) Delivery/Receive orders for delivery/receipt of securities.

Pay-in and Pay-out for 'A', 'B', 'T', 'C', 'F', 'G' & 'Z' group of securities The trades done on BOLT by the Members in all securities in CRS are now settled on BSE by payment of monies and delivery of securities on T+2 basis. All deliveries of securities are required to be routed through the Clearing House.

The Pay-in/Pay-out of funds based on the money statement and that of securities based on Delivery Order/Receiver Order issued by BSE are settled on T+2 day. Demat pay-in The member-brokers can effect pay-in of demat securities to the Clearing House either through the National Securities Depository Ltd. (NSDL) or Central Depository Services (I) Ltd. (CDSL). In case of NSDL, the member-brokers are required to give instructions to their respective Depository Participants (DPs) specifying settlement no., settlement type, effective pay-in date, quantity, etc.

As regards CDSL, the member-brokers give pay-in instructions to their respective DPs. The securities are transferred by the DPs to the Clearing Member (CM) Principal Account. The member-brokers are required to give confirmation to their DPs, so that securities are processed towards pay-in obligations.



CLEARING & SETTLEMENT PROCESS

5.7 Electronic and Paperless Trading

As a part of the SEBI's policy it was decided to introduce paperless trading and electronic book entry transfer in a phased manner. This allows time for the required infrastructure to develop and to gain acceptance of the investors and creates competencies of the markets. This approach proved beneficial and within a very short period of time ie. less than 12 months, a significant portion of trading volume on the stock exchanges were taken place in dematerialised form.

To facilitate SEBI to get a feedback on the progress of dematerialisation and also to suggest policy changes on timely basis, a Working Group has been constituted by the SEBI comprising of National Securities Depository Ltd (NSDL), Central Depository

Services Limited (CDSL), Stock Exchanges and various market participants viz., Custodians, Brokers, FIIs, mutual funds etc. These Working Group meets at regular intervals to review the progress and examine the issues involved in compulsory dematerialised trading to suggest further measures and improvements that can be inculcated to have transperency and smoothness in operations and protect investors.

The following are the major steps taken by the SEBI to increase the pace of dematerialisation and to ensure a speedy transition in stock trading:

- In order to facilitate the process of dematerialisation of securities, and dematerialised trading, SEBI and exchanges introduced an element of compulsion to be fulfilled by the individual and institutional investors to settle trades in stocks of listed companies.
- Primarily the institutional investors (FIs, FIIs, Mutual Funds and Banks) and Overseas Corporate Bodies (OCBs) were required to settle trades in the dematerialised form. Subsequently, the number of scrips traded in the exchange was increased in the second phases to 319. This number would be increased to 360 by May 31, 1999. These scrips comprises of all shares in the BSE Sensitive Index and CNX S&P Nifty indices, all the scrips in the 'A' group and most of the highly traded scrips in 'B1' group, accounting for more than 80% of market capitalisation and 90% of trading volume.
- It was further reviewed that there was a satisfactory progress in the dematerialisation of shares and also trading and settlement carried under dematerialised form. In the light of recommendations of stock exchanges, SEBI further decided to encourage retail investors to trade in the depository mode. Hence, with effect from January 4, 1999, the settlement of trades in the electronic form was made mandatory for all classes of investors for shares of 12 companies. Subsequently, the number of companies was increased in proceeding phases to 31. This number further increased to 104 by May 31, 1999 and would thus cover more than 90 per cent of trading volume on the Indian stock exchanges. In respect wit new innovations in electronic trading and recommendations made on time, all shares included in the BSE Sensex and NSE Nifty indices and other highly trades shares would be traded in dematerialised form by individual investors also.
- Conversion and delivery of dematerialised shares has been permitted in all listed physical securities segment in the stock exchanges. This has helped in to mitigate the problem of liquidity in dematerialised trading and also helped to integrate the order book in physical and dematerialised segments for players in these markets. The stocks were traded in terms market lot (Even Lots) and it was abolished in the shares of the companies which are in list of compulsory dematerialised trading for all classes of investors. This has improved the liquidity and retail interest as such investors can now take there simultaneous positions in the form of odd lots of 1, 3, 7 etc. without being affected by price disparity. Rolling settlement/ carry forward system has the benefit of speedier settlement of cash and securities. An option for rolling settlement has been introduced in the stock exchanges for the dematerialised trading.

- Procedures for trading and settlements were simplified and several safety points were introduced. Thus investors could now easily dematerialise their holdings in shares and were encouraged to participate in the process of dematerialisation. Guidelines were issued by the SEBI so that an investor could ask for dematerialisation of shares when he sends his shares for registration after purchase. This process helped to speed up the process of dematerialisation of shares and reduce the to-and-fro movement of shares between the companies and investors. In respect of shares of companies in the list of compulsory dematerialised trading for all classes of investors, "No delivery"-period, in the stock exchanges was reduced. This helped to improve the liquidity in such scrips and reduce the volatility in price during the non delivery period.
- To protect interest of small investors with small holdings of shares in the physical form, stock exchanges were advised by the SEBI to allow sale of shares up to 500 in number or Rs 25,000 in value in the physical form of securities.
- In order to improve the availability of infrastructure and develop the confidence of investors in depository services, SEBI took up the matter with the Reserve Bank of India to persuade banks to become depository participants (DPs). SEBI also requested the Department of Telecommunications (DoT) to allow banks which are acting as depository participants to use the closed user group connectivity with NSDL i.e. depository participants which are banks with NSDL.

5.7 Safety and Integrity of the Secondary Securities Market

In June 1998, the market had witnessed abnormal price fluctuation and huge volatility in stock prices. In order to contain excessive market volatility, certain risk containment measures were taken by the SEBI in consultation with the Inter-Exchange Co-ordination Group and the stock exchanges. The stock exchanges were also directed to ensure all net outstanding sales portion as at the end of the trading day commencing from June 17, 1998 would result in deliveries. As the measure was a temporary one, this decision was reviewed on July 06, 1998 and withdrawn. Other measures included introduction of concentration margin and incremental margin on carry forward trades.

- **Volatility Margins**

To contain the volatility in the market and to enhance safety in the market under conditions of abnormal price movement, the SEBI in consultation with the stock exchanges and market participants evolved a mechanism of imposition of margin on volatile scrips. The price bands for scrips were modified and a varying margining system for volatile scrips was introduced across all the stock exchanges.

Once a security attracts the volatility margin, the margin will continue on the security at the margin rate as of the last day of the previous trading period for the first two trading days in the subsequent trading cycle also. For the subsequent days of the trading period, margins applicable shall be as per rates prescribed above based on price variation during the current week or 5 per cent whichever is higher. If however, the direction of price variation has reversed in the current week and the price variation in the security has exceeded the threshold limits in the reverse direction, then the margins as per rates prescribed therefore shall apply.

Further, if prices have been volatile, say, upwards (or downwards) and are attracting margins on the buy side (or sell side), and if the price movement reverses and exhibits a decline (or increase) of 16 per cent or more, then the margins will be applicable on sell side (buy side) as per rates prescribed.

- **Price Bands**

To provide more trading flexibility and to ensure trading of a scrip on all trading days, weekly price bands of 25 per cent was withdrawn. Daily price bands was reduced from 10 per cent to 8 per cent.

- **Intra-day trading and exposure limits**

With a view to enhance market safety, during the year 1997-98, the SEBI decided that the upper limit for gross exposure of the member broker of the stock exchange would be fixed at 20 times the base minimum capital and additional capital of the member broker. Gross exposure is the sum total of overall open positions of a broker. Most exchanges have a gross exposure limit lower than 20 times for additional safety. This is in addition to the intra-day trading limits of 33 1/3 times the base minimum capital and the additional capital of the broker, which were introduced by the SEBI in 1996-97 and have already been implemented by all the stock exchanges. Together they have strengthened the risk management in the secondary market. To ensure margin are collected from the clients, it was made mandatory for member-brokers to collect margins from clients in all cases where the margin in respect of the client in the settlement, would work out to be more than Rs.50,000/-. Disclosures also have been made mandatory for the member-brokers with regard to the gross outstanding position of clients.

- **Setting up of trade/settlement guarantee fund by stock exchanges**

One of the shortcomings of the clearing and settlement process of the Indian stock markets was the absence of system to reduce counter-party risk. Managing this risk is essential for the safety and efficiency of the market. For this purpose, the exchanges have been required to set up trade guarantee funds or settlement guarantee funds. The main objectives of these funds is that in case of a failure of a member broker to fulfill his pay-in liabilities, the Fund would provide the necessary resources and thus ensure timely completion of settlements. Thus establishment of such funds would give greater confidence to investors in the settlement and clearing procedures of the stock exchanges. The NSE is operating a clearing corporation, the National Securities Clearing Corporation Limited. During the year 1998-99 the settlement guarantee fund schemes of Madras, Ahmedabad, OTCEI, Vadodara, Delhi and Inter-connected Stock Exchange India Limited (ISEIL) in addition to Bombay, Ludhiana, Calcutta and Bangalore (1997-98) have been granted approval by the SEBI, bringing the number of exchanges with settlement guarantee funds to 10. The stock exchanges at Hyderabad, Cochin and Bhubaneshwar have been granted an ‘in-principle approval’ to set up settlement guarantee funds subject to fulfillment of certain conditions. The aggregate corpus of the fund, of all the stock exchanges is over Rs. 1000 crores.

5.8 Types of Traders

5.8.1 Speculators (Speculating)

Speculating in futures increases risk not only by undertaking a futures position with potential high returns but also with the risk of a large loss. These players bet even for a small change and take position in bulk stocks. This creates a high risk position and they have huge turnover in the market.

5.8.2 Hedgers (Hedging)

Hedging exists when a future position is taken to reduce the risk of a current or anticipated cash position. These are normally in the market for a very high time and prefer buy now and sell later strategy. They don't expose themselves to a high degree of risk.

5.8.3 Arbitrageurs (Arbitrate)

Arbitrate provides a risk-free profit when a trader takes opposite positions in a cash asset and the associated futures counter it when these respective instruments are mispriced in relation to one another. They take benefits out of two different markets simultaneously and expose themselves to a very high degree of risk.

Example: Trading System of NSE:

The NSE trading system provides complete flexibility to members in the kinds of orders that can be placed by them. Orders are first numbered and time-stamped on receipt and then immediately processed for potential match. Every order has a distinctive order number and a unique time stamp on it. If a match is not found, then the orders are stored in different 'books'. Orders are stored in price-time priority in various books in the following sequence:

-Best Price

-Within Price, by time priority.

Price priority means that if two orders are entered into the system, the order having the best price gets the higher priority. Time priority means if two orders having the same price are entered, the order that is entered first gets the higher priority.

The Equities segment has following types of books:

Regular Lot Book

The Regular Lot Book contains all regular lot orders that have none of the following attributes attached to them.

- All or None (AON)

- Minimum Fill (MF)

- Stop Loss (SL)

Special Terms Book

Stop-Loss Book

Stop Loss orders are stored in this book till the trigger price specified in the order is reached or surpassed. When the trigger price is reached or surpassed, the order is released in the Regular lot book.

The stop loss condition is met under the following circumstances:

Sell order - A sell order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or falls below the trigger price of the order.

Buy order - A buy order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order.

Odd Lot Book

The Odd lot book contains all odd lot orders (orders with quantity less than marketable lot) in the system. The system attempts to match an active odd lot order against passive orders in the book. Currently, pursuant to a SEBI directive, the Odd Lot Market is being used for orders that have quantity less than or equal to 500 viz. the Limited Physical Market.

Auction Book

This book contains orders that are entered for all auctions. The matching process for auction orders in this book is initiated only at the end of the solicitor period.

Order Matching Rule

The best buy order is matched with the best sell order. An order may match partially with another order resulting in multiple trades. For order matching, the best buy order is the one with the highest price and the best sell order is the one with the lowest price. This is because the system views all buy orders available from the point of view of a seller and all sell orders from the point of view of the buyers in the market. So, of all buy orders available in the market at any point of time, a seller would obviously like to sell at the highest possible buy price that is offered. Hence, the best buy order is the order with the highest price and the best sell order is the order with the lowest price.

Members can proactively enter orders in the system, which will be displayed in the system till the full quantity is matched by one or more of counter-orders and result into trade(s) or is cancelled by the member. Alternatively, members may be reactive and put in orders that match with existing orders in the system. Orders lying unmatched in the system are 'passive' orders and orders that come in to match the existing orders are called 'active' orders. Orders are always matched at the passive order price. This ensures that the earlier orders get priority over the orders that come in later.

Order Condition

A Trading Member can enter various types of orders depending upon his/her requirements. These conditions are broadly classified into three categories: time related conditions, price-related conditions and quantity related conditions.

Time Conditions

DAY - A Day order, as the name suggests, is an order which is valid for the day on which it is entered. If the order is not matched during the day, the order gets cancelled automatically at the end of the trading day.

GTC - A Good Till Cancelled (GTC) order is an order that remains in the system until it is cancelled by the Trading Member. It will therefore be able to span trading days if it does not get matched. The maximum number of days a GTC order can remain in the system is notified by the Exchange from time to time.

GTD - A Good Till Days/Date (GTD) order allows the Trading Member to specify the days/date up to which the order should stay in the system. At the end of this period the order will get flushed from the system. Each day/date counted is a calendar day and inclusive of holidays. The days/date counted are inclusive of the day/date on which the order is placed. The maximum number of days a GTD order can remain in the system is notified by the Exchange from time to time.

IOC - An Immediate or Cancel (IOC) order allows a Trading Member to buy or sell a security as soon as the order is released into the market, failing which the order will be removed from the market. Partial match is possible for the order, and the unmatched portion of the order is cancelled immediately.

Price Conditions

Limit Price/Order – An order that allows the price to be specified while entering the order into the system.

Market Price/Order – An order to buy or sell securities at the best price obtainable at the time of entering the order.

Stop Loss (SL) Price/Order – The one that allows the Trading Member to place an order which gets activated only when the market price of the relevant security reaches or crosses a threshold price. Until then the order does not enter the market.

A sell order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or falls below the trigger price of the order. A buy order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order.

E.g. If for stop loss buy order, the trigger is 93.00, the limit price is 95.00 and the market (last traded) price is 90.00, then this order is released into the system once the market price reaches or exceeds 93.00. This order is added to the regular lot book with time of triggering as the time stamp, as a limit order of 95.00

Quantity Conditions

Disclosed Quantity (DQ) - An order with a DQ condition allows the Trading Member to disclose only a part of the order quantity to the market. For example, an order of 1000 with a disclosed quantity condition of 200 will mean that 200 is displayed to the market at a time. After this is traded, another 200 is automatically released and so on till the full order is executed. The Exchange may set a minimum disclosed quantity criteria from time to time.

MF - Minimum Fill (MF) orders allow the Trading Member to specify the minimum quantity by which an order should be filled. For example, an order of 1000 units with minimum fill 200 will require that each trade be for at least 200 units. In other words there will be a maximum of 5 trades of 200 each or a single trade of 1000. The Exchange may lay down norms of MF from time to time.

AON - All or None orders allow a Trading Member to impose the condition that only the full order should be matched against. This may be by way of multiple trades. If the full order is not matched it will stay in the books till matched or cancelled (http://www.nseindia.com/products/content/equities/equities/trading_system.htm).

5.9 Summary

Indian secondary markets today are changing its pace dynamically. It is observed that with the changing dimensions of trade has made the markets more volatile and competent. The price discovery is easy and the mechanism is revised on continual basis. IT has played a significant role in shaping the corpus of market. It has made it easier to access the market an it has brought the market to the investors door step. With increasing usage of IT markets have witnessed tremendous growth on one hand and on the other side it has raised various security issues also. Exchanges nowadays have new techniques adapted to solve these issues and SEBI is continuously revising laws and bye laws under SCRA to safeguard the interest of investors and other players in the market.

5.10 Self Assessment Questions

1. Briefly discuss trading and process of trading cycle in the Indian Security Market?
2. Enumerate the essentials and benefits of online trading system?
3. Discuss the Trading Mechanism of Indian exchange?
4. Describe Clearing and settlement process of equity trading in Indian stock exchange?
5. How does electronic and paperless trading takes place in exchange detail by giving suitable example?

5.11 References Books

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Unit : 6 - NEAT System

Structure of Unit:

6.0 Learning Objectives

After reading this unit, you would be able:

- To identify the characteristics of trader workstation screen.
- To understand the various functions available on the NEAT screen.
- To apply the knowledge of the various functions in real life while working on the terminal.

6.1 Introduction

National Stock Exchange uses National Exchange for Automated Trading (NEAT) software for conducting its trading. To make trading easier and simpler NEAT screen consist of various functions and shortcut keys. These functions make it easier for traders to trade, place buy or sell order, modify order, market watch, lot traded, prices etc. This can be observed that NEAT is a practical topic and can be used to trade. One can see to this manual and can make NEAT screen to facilitate the trader. It allows to access faster incorporation of price sensitive information into prevailing prices in fraction of seconds, thus increasing the informational efficiency of markets to take decision. It enables market participants, traders, irrespective of their geographical locations, to trade with one another at any point of time during the trading sessions and improves the depth and liquidity of the market. It provides full security to traders by accepting orders, big or small, without revealing their identity. It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety. In the very first year of its operation, NSE became the leading stock exchange in the country.

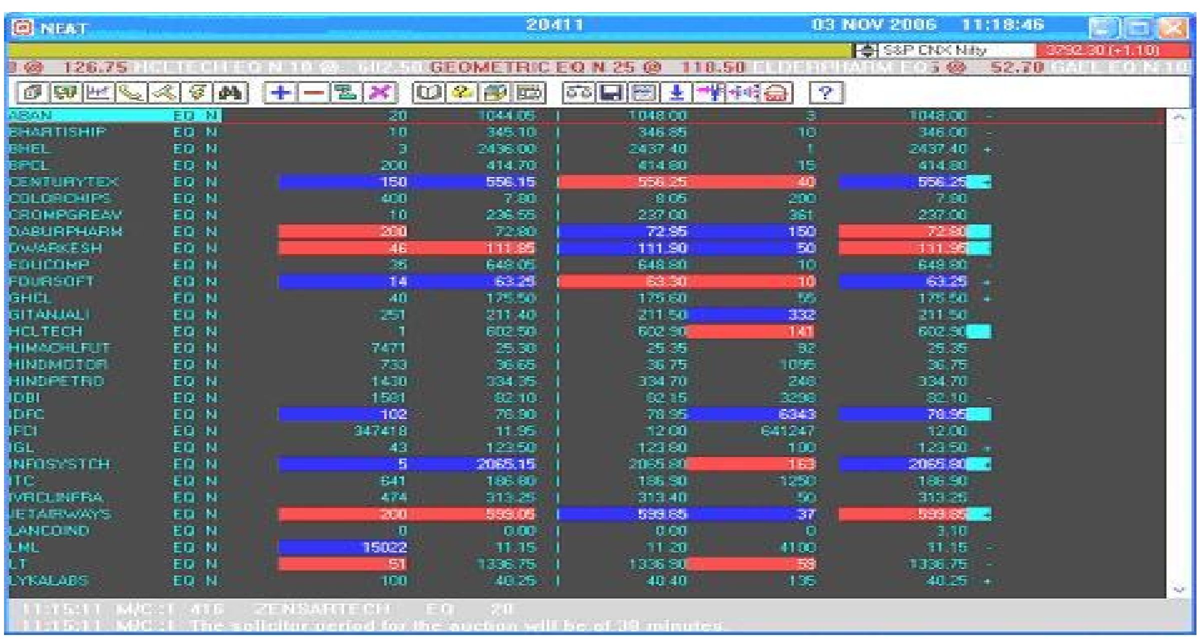
Trading Network of NS-NSE has main computer which is connected through Very Small Aperture Terminal (VSAT) installed at its head office. The main computer runs on a fault tolerant mainframe computer at the Exchange. Brokers have their terminals installed at in the premises which are connected through VSAT's /leased lines/modems. An investor informs a broker to place an order on his behalf and take a simultaneous position in the market. The broker enters the order through his PC, which runs on a Licensed Windows O/S and sends signal to the Satellite via VSAT/leased line/modem to the exchange. The signal is directed to mainframe computer at NSE via VSAT at NSE's office in a fraction. A message relating to the order activity is broadcast to the respective member terminal to book trade. The order confirmation message is immediately displayed on the PC of the broker and this has 2 options showing acceptance & rejection.

This order matches with the existing passive order(s), otherwise it waits for the active orders to enter the system. On order matching, a message is broadcast to the respective member related to execution or pending position. The trading system operates on a strict price time priority. All orders received on the system are sorted, with the best priced order getting the first priority for matching i.e., the best buy orders match with the best sell order. Similar priced orders are sorted on time priority basis, i.e. the one that is punched first gets priority over the later order for execution. Orders are matched automatically by the computer keeping the system, transparent and fair for both exchange and trader. Where an order does not find a match, it remains in the system for the day till a fresh order comes in or the earlier order is canceled or modified by the trader.

The NSE trading system (NEAT) generates and maintains an audit trail of the orders entered in the system by assigning a unique order number to all the orders placed on the NEAT system. The system is normally made available for trading on all days except Saturdays, Sundays and other holidays. Holidays are declared by the Exchange from time to time.The system is normally made available for trading on all days except Saturdays, Sundays and other holidays. Holidays are declared by the Exchange from time to time.

6.3 NEAT Screen

NEAT screen comprises of various segments which are as follows:



6.2 Title Bar:

The contents of the Title Bar on NEAT System are as follows:

a. Logo: It is a trademark of NSE portal ie. NEAT.

b. Name of the software: The software name is NEAT (National Exchange of Automated Trading) which is displayed on computer screen.

c. Name of the company: The name of the trading member ie. One who has taken the membership of NSE is displayed.

d. Login ID number: Those trading members who have cleared NCFM exam and obtained the certification they are entitled to get the Login Id from NSE to trade

e. Current date in format date month year (for example 01.01.2007 should 01 JAN 2007)

f. Current time in format - hours: minutes: seconds

6.2.1 Sub Title Bar

It shows the change in current INDEX of S&P CNX NIFTY with it changes from yesterday's closing in bracket along with +/- sign. For example if the current index is 6000 and the change is 120 points, then it will show like: S&P CNX NIFTY 6000(+ 120), S&P CNX 600, CNX 100, CNX IT, CNX Nifty Junior, S&P CNX Defty, Bank Nifty and CNX Midcap.

- **Second Sub Title Bar:-**

It is the ticker window which shows the last traded trade for the day that comes in the sequence of symbol, series, market type, quantity and price in red colour for sell and in white colour for buy a certain amount of stock.

- **Tool Bar: -**

The tool bar of the NEAT software has 23 icons in total which can be operated by both mouse as well as key-board using shortcut keys.

- **Market Watch: -**

Market Watch screen is the used to setup and view trading details of the securities that are selected by the user based on his priority of holding or interest. For each security positioned in the market watch window is dynamically updated.

- **System Message Window: -**

This window shows the messages regarding order/trade confirmation / modification / cancellation etc.

ORDER SCREEN

6.3 Types of Orders

- **Regular Lot (RL) Orders:**

The term Regular Lot denotes that the order has no special condition associated with it. When a client places his order in the software, the system searches the corresponding Regular Lot order existing in that market (Passive orders). If it does not find a match at the time the order is entered the system, the order is winded up in the Regular Lot book as a passive order. By default, the Regular Lot book appears in the order entry screen in the normal market.

- **Special Trade (ST) Orders:**

The term Special Trade stands for special orders having either AON (all or none) or MF (minimum fill), comes under the category of Special Trade. Here all or none means that if someone is placing an order of big quantity or an order of bigger lot size and he doesn't want to get less quantity to be executed at the time of deal, and then he can place an order that either all the quantity should get executed or none of the quantity should be allotted to him. Same in the case of minimum fill which means that at least in the ordered quantity this much of minimum quantity should be received and executed at the time of deal or none of the quantity should be transferred in his name. It is a vital tool used for buyback of shares at time of reducing liability by the company.

- **Stop Loss (SL) Orders:**

The term SL means stop loss order which are placed for minimizing/restricting the loss arising out of the deal. During the event of a market crash or a rapidly sky rocketing market, it is not possible to place the order for long or short position immediately and the client might have to suffer huge losses. To avoid such sudden losses and to restrict the loss in case the market moves rapidly in an unfavorable direction, stop loss orders can be used. Stop loss orders are stored in this till the trigger price specified in the order is reached or surpassed. When the trigger price is reached or surpassed, the order is released in the regular lot book. A long/short order in the stop loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order. In these types of orders two types of rates are required, one is the trigger price, on which order will be activated in the Normal market and second is, the trade price, which can be market rate also. For buy stop loss order, the trigger price has to be less than or equal to limit price.

Trigger Price – Price at which an order gets triggered from the Stop Loss book is called Trigger price.

Limit Price - Price of the orders after triggering from Stop Loss book.

- **Negotiated Trade (NT) Orders:**

The term Negotiated Trade book can be denoted as; it contains all negotiated trades captured by the operators before they have been matched against their counter party. These entries are matched with identical counter party for similar order. These orders contain a counter party code in addition to the other orders details.

- **Odd Lot (OL) Orders:**

The term OL Stands for Odd Lot book which contains all odd lot orders (orders with quantity less/more than marketable lot). The operator matches an active odd lot order with a passive odd lot order in the book. Earlier, a market lot used to be of 100 units, so in order to place orders for less/more than 100 units odd lot market was used. But today, a lot is of 1 unit only, hence the need of odd lot market is not there any more hence, this operation is not working now-a-days.

- **Retail Debt (RD) Orders:**

The term RD stands for RETDEBT book which contains all RETDEBT orders. The RETDEBT market facility on the NEAT system of capital market segment is used for transactions in Retail Debt Market session. Trading in Retail Debt Market takes place in the same manner as in equities (capital market) segment. An operator matches an active order with a passive order.

- **Auction Market (AU) Orders:**

The Auction market can be stated as a market where auctions in orders are entered for carrying on balancing trade. Auctions are initiated by the Exchange on behalf of trading members for settlement of outstanding lots of share. The main reasons are Shortages, Bad Deliveries and Objections in the tradable lots of clients. The auction period is initiated at 12:00 P.M to 12:30 P.M. The matching process for auction orders in this book is initiated only at the end of the auction period. The auction ending period is between 12:30 P.M. and 1:00 P.M.

6.4 Key Functions

- **Outstanding Order (F3):**

This function is used to enable the User to view the outstanding orders of buying/selling for a selected security. An outstanding order is an order that has been entered by the user, but which has not yet been completely traded or cancelled during the trading session of the exchange. The User is permitted to see his own/client's orders and can modify/cancel the orders till it gets executed in the exchange software. All the figures are till the time of invoking the window of NEAT till the trade confirms.

Invoking Outstanding Orders:

To invoke Outstanding Order screen, press [F3] key. If a particular security is selected, the details of the selected security defaults in the selection screen or else the current position in Market Watch defaults.

- **Market Watch (F6):**

This screen is used to set-up and view trading details by the client of exchange operating NET software of the securities that are selected by the users. For each security in the market watch, market information is dynamically updated on ongoing basis and the price change can be seen instantly. The one line market information displayed is for current best price orders available in the Regular Lot Book.

For each security the following information is displayed:

Symbol, Series and Market type

The corporate action indicator “Ex/Cum"

The total buy order quantity available at best buy price

Best buy price

Best sell price

Total sell order quantity available at best sell price

The last traded price

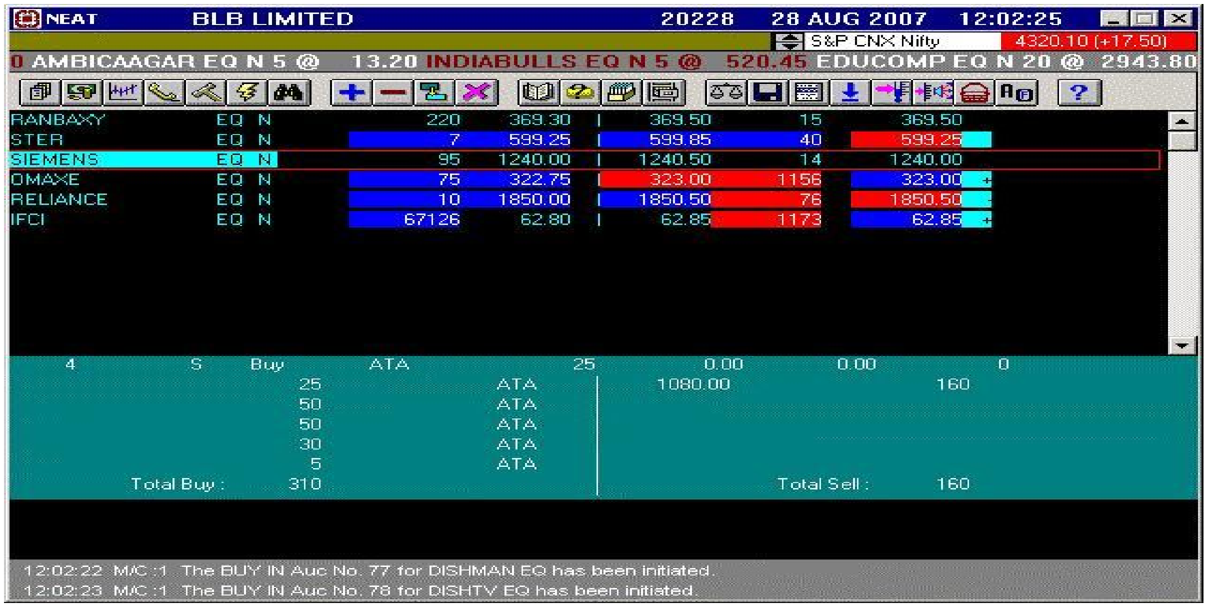
The last trade price change indicator

Increase/Decrease indicator

The no delivery period indicator "ND"

- **Market by Order (F6):**

The purpose of Market by Order (MBO) is to enable the User, to view outstanding orders in the order books, in the order of price/time priority for a selected security are displayed. It shows best five orders by price time priority for buyers as well as for sellers for the selected scrip. This function is not available for Equity market; it only works for Auction markets. This function can be invoked by using F6 key or by clicking on the first icon in the tool bar.



- **Auction by Order**

The Auction No. field is compulsory only to view Auction orders details.

The User can change any or all information by typing over the appropriate fields. The [Tab] and [Shift+Tab] keys can be used to navigate between the fields. After entering the selection details, press [Enter] key. The detailed MBO screen is displayed. This function is now not available for NORMAL and RETDEBT market.

- **Market by Price (F6):**

In the NEAT software as the name suggest it shows best five buy/sell rates on the basis of price time priority with quantity available for a specified security as per client selection. This window is dynamically updated in terms pf price and quantity traded. By pressing F6, the following window displays: Symbol, Series and Type of the scrip, is invoked. The output of this function contains the same fields as that of MBO (Market by Order).

Special Features of MBP:

1. Regular lot & special term orders can be viewed in the MBP.
2. The status of a security is indicated in this screen. 'P' indicates that the security is in the pre-open phase and 'S' indicates that the security is suspended.
3. The percentage change for last trade price with respect to previous day's closing price and the average trade price of the security in the given market, are the additional fields in the screens.
4. No un-triggered stop-loss order will be displayed on the MBP screen.
6. Only orders for the best 6 prices information are displayed.

Press enter to view the best five buy/sell rates.

All the figures are till the time of invoking the window.

- **Activity Log (F7):**

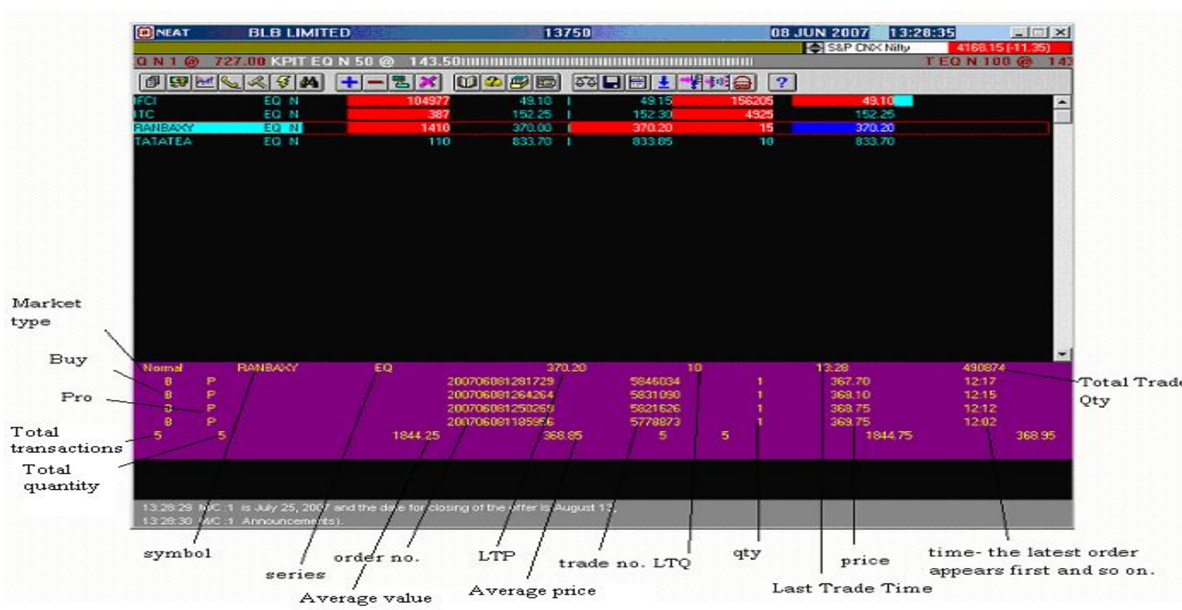
The Activity Log shows all the activities which have been performed by the client during the trading session on any order. These activities include order modification / cancellation, partial/full trade, trade modification/cancellation during the session. It displays information of only those orders in which some activity has taken place on intraday basis. It does not display those orders on which no activity has taken place. All the figures are till the time of invoking the window.

Invoking AL:

To invoke Activity Log, press [F7] key. If a particular security is selected, the details of the selected security defaults in the selection screen or else the current position in Market Watch defaults. Details of security in the selection screen can also be defaulted from the last action.

- **Previous Trades (F8):**

The purpose of this window is to provide security wise information to Users for their own stocks traded during the trading session. The 'Trades' window displays the executed orders on real time basis. The trade details cannot be modified or cancelled, since the trades reflected in this window are already executed. The main advantage of this function is that it facilitates viewing the details of each trade separately which cannot be viewed in the Net Integrated Position window, wherein the entire buy/sell quantity is displayed with average price. All the figures are till the time of invoking the window.



- **Invoking Previous Trades Screen:**

Client/ dealer can invoke Previous Trades screen by pressing [F8] key. If a particular security is selected, the details of the selected security defaults in the selection screen or else the current position in Market Watch defaults can be seen on the screen. User is provided with the client account type field. On giving an account type in this field, it is possible to view all previous trades for a particular client. The user can also blank out the Symbol & Series and get all the trades for a particular user id. The page up/page down keys will help the user to move from one security to another. For further details please see the Previous Trades screen.

- **Snap Quote (F9):**

The Snap Quote is a feature available in the system to get instantaneous market information on a desired security of your choice and preference. This is normally used for a security that is not setup in the Market Watch window and can be available for research. The information displayed is same as that in Market Watch window i.e. Corporate action indicator "Ex/Cum", the total buy order quantity, best buy price, best sell price, total sell order quantity, last traded price, last trade price change indicator and the no delivery indicator "ND". The information can be viewed without disturbing the market watch.

- **Market Enquiry (F11):**

The purpose of the Market Enquiry is to enable the User to view the market statistics of a particular security in the particular market like NSE. It also displays the open price and previous close price for a security so as to take necessary decisions. This function is used to view the total market information of the selected scrip by the user. This screen is not dynamically updated.

It displays the security status of the security selected.

'S' indicates that the security is suspended;

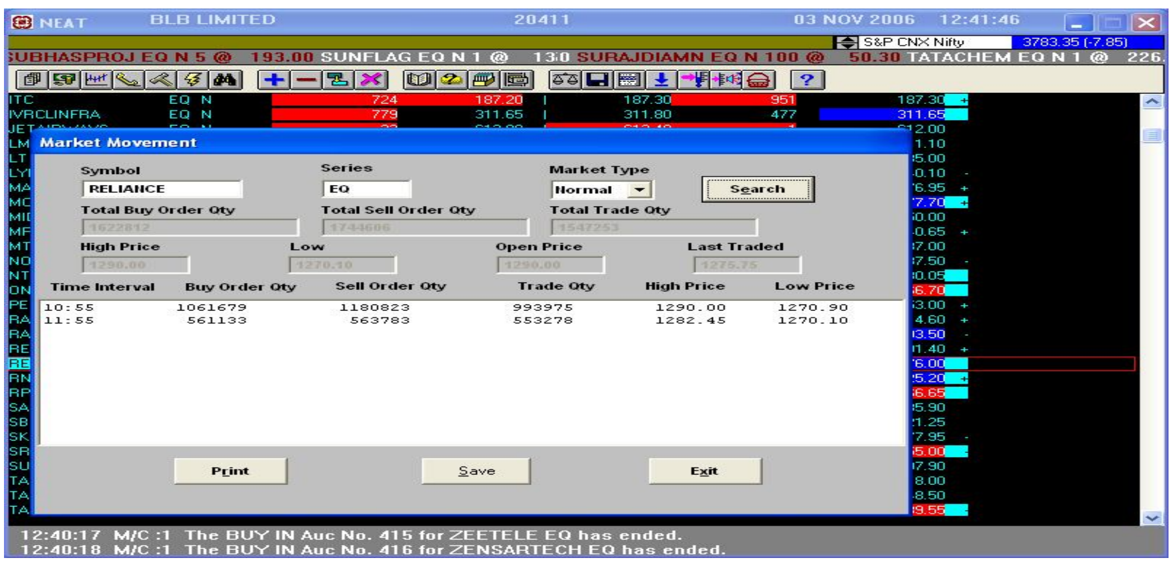
'P' indicates that the security is in pre open (only for normal market) and in absence of the above indicators the security is open for trading.

An indicator for corporate actions for a security is displayed on the screen.

6.5 Other Functions

- **Market Movement (Shift + F10):**

In this function we can see the market movement and performance of selected scripts on hourly basis. We can also print and save this report as per our requirement to take necessary decisions. The Market Movement screen provides information to the User regarding the movement of a security for the current day on orders/trades done today. The information displayed is from the time when market opened today in chronological sequence. This Enquiry gives the snap shot for a particular security for a time interval as parameterized by the Exchange.



- **Online Backup (Alt + F7):**

This facility of Online Backup is specifically designed for the users who invoke to take a backup of all order and trade related information intraday/ same day T+1 basis. The information available is for the current day only. Online backup is in the TXT file format for the market segments such as Derivatives and Equities for various functions like Trade, Order, Spread. The online backup facility involves a number of filtering options for the user, like the market type, the instrument type and the duration of required report can be specified in terms of date and time for the user.

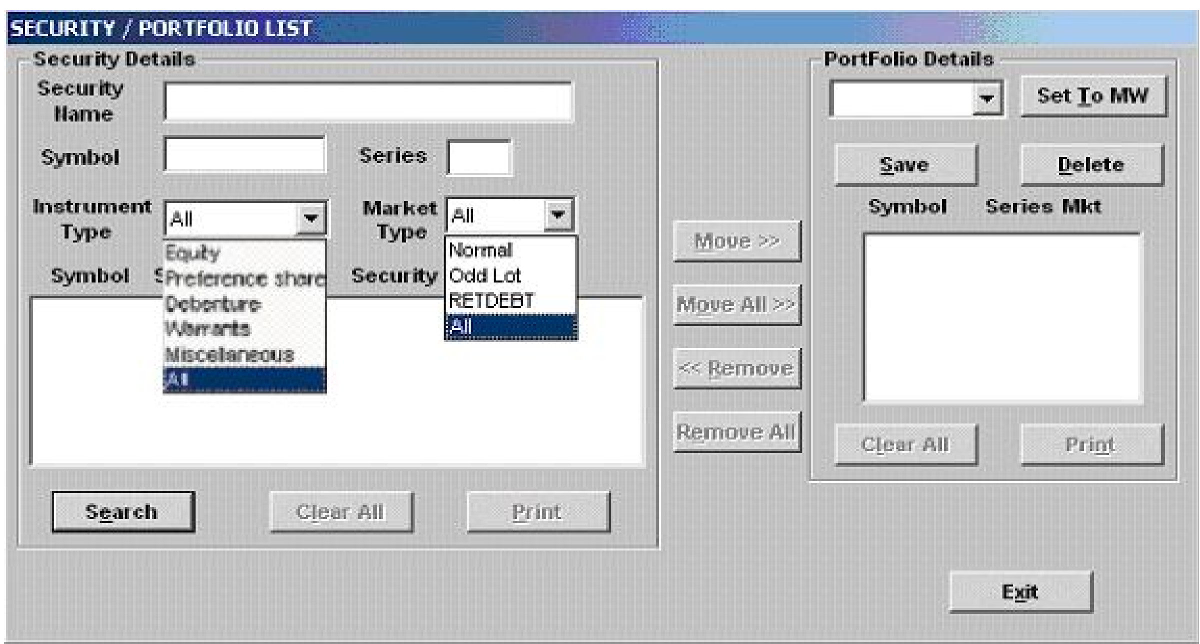
- **Basket Trading (Ctrl + F6):**

The purpose of Basket Trading is to provide NEAT users ie. client/ dealers with a facility to create order entry file for a selected portfolio or basket of scrips. By putting the value, the orders will be created for the selected portfolio of securities according to the ratios of their market capitalization.

Reverse Basket Trading: The Purpose of Reverse Basket Trading is to provide the users with an offline file for reversing the trade that has taken place for the Basket Order. This file will contain orders of different securities of the selected basket file. The Orders will be created according to the volume of trade that had taken place for the specific basket. This can also be used to monitor the current status of the basket file as the latest status of the order is displayed in the list box. The functionality of creating reverse basket offline order file, based on orders at the time of creating the basket, will continue to be available.

- **Security List (Shift + F7):**

This is a facility for the User to list all the securities available in the trading system related to market watch for an instrument type EQ, FUT, OPT etc. The User can also get the list of all the securities available in the system by leaving the instrument type blank. The User can select any of the security mentioned on the screen as they are used as default for the next operation based on user defined pattern.



- **Settings of Security List**

Information about various instrument types is given. Instruments can be equity shares, preference shares, warrants, debentures and miscellaneous. Information about various market types is also available in the Market Type field. They are:

Normal, Ret debt and Odd Lot.

- **Security Descriptor (Shift + F8):**

This function can be invoked by either pressing the [Shift+F8] keys or double clicking on the security setup in the Market Watch screen.

The DPR i.e. Daily Price Range, displays the permissible price band for a security for the current trading day.

- **Auction Enquiry (Shift + F11):**

Through this function user can view all the details related to auction of the selected scrip for the day. It shows: The following are the different status displayed for an auction security:

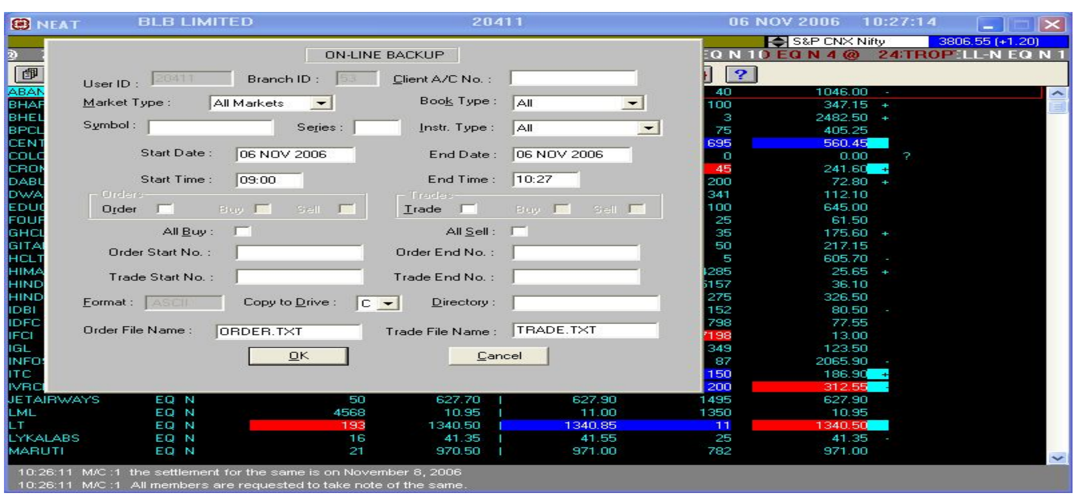
S - Solicitor Period of Auction.
M – Order matching by the operator
F – Auction is finished
X - Auction is deleted
P - Auction is outstanding and yet to begin

- **Order Status (Shift + F12):**

The purpose of the Order Status is to look into the status of the dealers own specific orders. The screen provides the current status of the orders with the other order details. The order status screen is not dynamically updated. In case the order is being traded, the trade details are displayed. In case of multiple trades the display of the orders can be seen by scrolling down. It shows the status of orders. To view the status of an order, type the Order Number and press ‘Enter’. On pressing ‘enter’, it shows the details of the specified order number.

The following example shows a buy order of ITC for 1 share @ Rs. 166.

- **Online Backup (Alt + F7):**



This function is used to take the backup of trades and orders, (as discussed earlier in F12 key function)

6.6 Supplementary Menu for Specific Features

1. Report selection
2. Full message display (CTRL + F10)
3. Color Selection
4. Print System Message (ON/OFF)
6. Print Order/Trade Confirmation Slip (ON/OFF)
6. Ticker Selection
7. Market Movement (Shift + F10)
8. Most Active Securities
9. Reprint Order/Trade Confirmation Slip
10. Net Position (ALT +F6)
11. Online Backup (ALT + F7)
12. One Line or Tabular Slips
13. Index Enquiry (ALT + F3)
16. User Order Value Limit Setup
16. Symbol wise User Order Quantity Limit
16. SUOQL Bulk Upload
17. Off Line Order Entry
18. Order Limits
19. Order Attribute Selection
20. Yield Calculator (Disabled)
21. Net Position Backup (CTRL + F2)
22. Client Master Maintenance
23. Index Trading
26. Reverse Basket Trading
26. Reset User ID
26. About

6.7 Buy Back Shares (Ctrl + F6)

The purpose of Buy Back Trade functionality is to give information to the market about the buy back trades executed from the start of the buy back period till current trading date in the securities whose buyback period is currently on. It provides information about Symbol, Series, Day's high price, Day's Low Price, Day’s Weighted Average Price, Day’s Volume, Total Volume, Highest/Lowest/Weighted Average Prices till previous day; Buy Back Start & End date.

The Buyback Trade functionality also provides users with the information about the buyback trades going in various securities. The front screen shows Symbol, Series, Low price (Today), High price (Today), Weight age. Average price, Volume (Today), & Previous day Volume.

The user after selecting a particular row from the buyback list box can view further information via Symbol, Series, Start date, End date, Total Traded Qty (Till date), Previous High price, Previous Low price and Wt avg. price till date of buyback scheme. The Buyback broadcast updates the information.

6.8 Summary

The NEAT screen is a user friendly screen which helps a dealer /clients to put orders which in turn will become trades if they get matched during the session. The main screen of NEAT consists of Title bar, Sub - title bar, Second sub-title bar, Tool bar, Market watch and System message window for user interfacing. There are various types of orders that can be entered in the system while carrying trade. They are regular lot orders, special trade orders, stop loss orders, negotiated trade orders, odd lot orders, retail debt orders and auction market orders to facilitate trade and traders. There are many key functions like Outstanding Order, Market Watch, Market By Order, Market By Price, Activity Log, Previous Trades, Snap Quote and Market Enquiry. There many other functions like Market Movement, Online Backup, Basket Trading, Security List, Security Descriptor, Auction Enquiry, Order Status and Online Backup. The supplementary menu provides specific features related to NEAT software to make it easy to operate. It provides additional features like report selection, full message display, colour selection, print system message, trade confirmation slip ticker selection, market movement, reprint order, net position, online backup, index enquiry etc to distinct the features and trade allocated in software for trading.

6.9 Self Assessment Questions

1. What is the importance of activity log & its special features?
2. What is basket trading?
3. What are supplementary functions?
4. Describe all the windows of the NEAT screen?
5. "The purpose of the Order status is to look in to the status of one of the dealer's own specific orders". Specify about the same and its special features?
6. Explain about the market watch window and the information displayed in it to simplify users work.

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Unit : 7 - Debt Market-“Retdebt” System

Structure of Unit:

7.0 Objectives

After completing this unit, you would be able to:

- Understand RETDEBT Market
- Understand RETDEBT Market trading and settlement system
- Understand features of RETDEBT Market
- Understand RETDEBT Market orders
- Understand RETDEBT Market auction system

7.1 Introduction

With a view to encouraging wider participation of all classes of investors across the country (including retail investors) in government securities, the Government, RBI and SEBI have introduced trading in government securities for retail investors. Trading in this retail debt market segment (RDM) on NSE has been introduced w.e.f. January 16, 2003. Trading shall take place in the existing Capital Market segment of the Exchange. In the first phase, all outstanding and newly issued central government securities would be traded in the retail segment. Other securities like state government securities, T-Bills etc. would be added in subsequent phases.

Trading in the Retail Debt Market takes place in the same manner in which the trading takes place in the equities (Capital Market) segment. The RETDEBT Market facility on the NEAT system of Capital Market Segment is used for entering transactions in RDM session. Members eligible for trading in RDM segment: Trading Members who are registered members of NSE in the Capital Market segment or Wholesale Debt Market segment are allowed to trade in Retail Debt Market (RDM) subject to fulfilling the capital adequacy norms.

7.2 Features of Retdebt market

The trading system features and user navigation for RETDEBT Market are described below. Further details are available on the on-line help facility of NEAT system.

- **Setting up Securities in Market Watch-** For setting up securities in the Market Watch screen, the user has to press the function key [F4], enter the required details in Symbol, Series and Market Type fields and press [Enter].

  The default option displayed in the market type field is 'N'. This can be changed to 'D' using the Up/Down arrow keys.
- **Order Entry-** Buy/ Sell orders can be entered in RETDEBT Market using the function keys [F1] and [F2] and selecting 'RD' in the Book Type field.
- **Quantity-** Order quantity should be in multiples of Market Lot. Quantity conditions such as MF, AON and DQ are not allowed.
- **Price-** Members can enter either market orders or limit price orders. Order price for limit price orders should be in multiples of tick size.
- **PRO/CLI/WHS-** In the Pro/Cli/Whs field only 'Pro' and 'Cli' orders are allowed. 'WHS' option is not available.
- **Time Conditions-** Members can specify time conditions as 'Day' or 'IOC'.
- **Participant Code-** A valid Participant Code can be entered in this field. Other options allowed are 'O', 'C', 'NCIT' 'INST' and the trading member's own id. Orders in book type NT and SL are not allowed.
- **Order Cancellation/Modification -** Order cancellation and modification is allowed for orders entered in the RETDEBT Market. Both Single and Quick Order Cancellation functions are available. In order to affect Quick Cancellation of orders for a security in RETDEBT Market, a member has to press [Shift+F3] to invoke Quick Order Cancellation screen and select 'RD' in the Book Type field. Quick Cancellation can also be done for all securities in the RETDEBT Market by selecting the Book Type as 'RD' and other parameters as relevant.
- **MBP-** Member can query order information for the RETDEBT Market in MBP by selecting 'RETDEBT' as book type in the selection screen. Orders are stacked according to price in MBP. The high, low, last trade price, percentage change and average trade price figures are calculated with respect to trades in RETDEBT Market.
- **Market Inquiry-** Security statistics for RETDEBT market can be viewed by selecting 'RETDEBT' as market type.
- **Outstanding Orders/Activity log/ Previous Trade -** Outstanding order/ Activity log/ Previous Trade information in a particular security can be viewed for RETDEBT Market by selecting the book type 'RETDEBT' in the respective selection screens.

- **Order and Trade Confirmation Slips -** The order confirmation slip for orders entered in RETDEBT Market displays 'RD' as Book Type field. Similarly, trade confirmation slip generated for RETDEBT Market trades show 'D' in the Market Type field.
- **Net Position-** The Net Position screen displays consolidated statistics for all markets as well as separately for each market.
- **Market Movement-** Market Movement statistics for a security can be viewed by selecting market type as 'RETDEBT'.
- **Most Active Securities -** This screen display consolidated statistics i.e. traded value, traded quantity, no of trades for a security across the markets. However, price statistics displayed in this screen are with respect to Normal Market only.
- **On-line Backup-** In the On-line Backup function a facility is provided to select order/trades based on Market Type. Alternately, members can take a backup for all markets by selecting 'All' in the Market Type field.
- **Full Message Display-** In Full Message Display, messages can be filtered on Symbol and Series. The option to filter messages for a market type is presently not available.
- **Offline Order Entry-** This function is available for RETDEBT Market. The structure for the input file is given in the online help.
- **Branch/User Order Value Limit-** Branch/User Order Limit is applicable for a particular Branch/User for orders across all Markets.
- **Securities Order Quantity Limit-** Securities Order Quantity Limit is applicable for a particular security across all Markets.
- **Order Limits-** Order limits set by a user are applicable for a single order across all Markets.
- **Ticker Selection-** A facility is provided for filtering securities in the ticker for RETDEBT market.
- **Reports-** Trades report generated for members i.e. Trades Done, Order Log and Open Orders report, displays records in ascending order of security name. Within a security records are displayed by Market Type.
- **Bhav Copy-** Security statistics pertaining to RETDEBT Market trades are shown separately in the Market Statistics report.

7.3 Trading in RETDEBT

- **Trading Parameters**

The trading parameters for RDM segment are as below:

Face Value	Rs. 100/-
Permitted Lot Size	10
Tick Size	Rs. 0.01
Operating Range	+/- 5%
Mkt. Type Indicator	D (RETDEBT)
Book Type	RD

- **Trading System**

Trading in RDM takes place on the 'National Exchange for Automated Trading' (NEAT) system, a fully automated screen based trading system, which adopts the principle of an order driven market. The RETDEBT Market facility on the NEAT system of Capital Market Segment is used for entering transactions in RDM session.

- **Trading Cycle**

Trading in Retail Debt Market is permitted under Rolling Settlement, where in each trading day is considered as a trading period and trades executed during the day are settled based on the net obligations for the day. Settlement is on a T+2 basis i.e. on the 2nd working day. For arriving at the settlement day all intervening holidays, which include bank holidays, NSE holidays, Saturdays and Sundays are excluded. Typically trades taking place on Monday are settled on Wednesday, Tuesday's trades settled on Thursday and so on.

7.4 Risks in RETDEBT Market

- **Base Capital & Net worth Requirements**

Clearing members of Capital Market and Trading members of the WDM segment of the Exchange will be allowed to participate in clearing and settlement of trades done in Government securities, subject to a minimum net worth of Rs.1 crore.

An initial contribution to the Settlement Guarantee Fund (SGF) of this market by way of interest free security deposit (IFSD) of Rs.5 lakhs is required to be kept with NSCCL. A member desirous of participating in this segment may opt to set aside a contribution of Rs.5 lakhs from his additional base capital available on the Capital Market segment and / or Futures & Options segment (s) towards this IFSD.

- **Margins & Gross Exposure Limits**

Mark to market margins will be applicable on all-open positions in government securities and shall be calculated on the basis of ZCYC prices. This margin shall be payable on T + 1 day. Institutions that are permitted under the relevant regulations to transact only on the basis of giving and taking delivery will operate through the custodial mechanism and shall be exempt from margin as in the case of the equities. Custodial trades on behalf of Provident Funds transacting through SGL – II accounts shall also be eligible for margin exemption. The gross exposure in respect of these securities shall not exceed 20 times of the IFSD. Any member desirous of a higher exposure will be required to bring in additional base capital as in Capital Market segment.

7.5 Clearing and Settlement

National Securities Clearing Corporation Limited (NSCCL) is the clearing and settlement agency for all deals executed in Retail Debt Market.

- **Salient features of Clearing and Settlement in Retail Debt Market segment**

1. Clearing and settlement of all trades in the Retail Debt Market shall be subject to the Bye Laws, Rules and Regulations of the Capital Market Segment and such regulations, circulars and requirements etc. as may be brought into force from time to time in respect of clearing and settlement of trading in Retail Debt Market (Government securities).
2. Settlement in Retail Debt Market is on T + 2 rolling basis viz. on the 2nd working day. For arriving at the settlement day all intervening holidays, which include bank holidays, NSE holidays, Saturdays and Sundays are excluded. Typically trades taking place on Monday are settled on Wednesday, Tuesday's trades settled on Thursday and so on.
3. Clearing and settlement would be based on netting of the trades in a day.
4. NSCCL shall compute member obligations and make available reports/data by T+1. The obligations shall be computed separately for this market from the obligations of the equity market.
5. The settlement schedule for the Retail Debt Market (Government Securities)

Sr.No.	Day	Description
1	T	Trade Date
2	T + 1 (11:00 a.m.)	Custodial Confirmation
3	T + 2 (10.30 a.m.)	Securities & Funds pay-in
4	T + 2	Securities & Funds pay-out

6. Funds settlement and securities settlement shall be through the existing clearing banks and depositories of NSCCL, in a manner similar to the Capital Market segment. The existing clearing bank accounts shall be used for funds settlement.
7. The existing CM pool account with the depositories that is currently operated for the CM segment, will be utilized for the purpose of settlements of securities.
8. In case of short deliveries, unsettled positions shall be closed out. The close out would be done at Zero Coupon Yield Curve (ZCYC) valuation for prices plus a 5% penalty factor. The buyer shall be eligible for the highest traded price from the trade date to the date of close out or closing price of the security on the close out date plus interest calculated at the rate of overnight FIMMDA-NSE MIBOR for the close out date whichever is higher and the balance shall be credited to the Investor Protection Fund.
9. Members may please note that the penal actions and penalty points shall be similar to as in Capital Markets.

7.6 Order Management

Order Management in RETDEBT Market in NSE consists of following steps :

1. <u>Entering Orders</u>

The trading member/ broker/ client can enter orders in the normal market session, odd lot market, RETDEBT and auction market. A user can place orders during the trading session in any of the above mentioned markets by invoking the respective order entry screens. When the user invokes the order entry screen, the fields that are taken as default are Symbol, Series and Book Type. In case of other fields, the system takes the following defaults:

***Symbol* –** Shows the symbol of the scrip to be traded or of users interest.

***Series* –** Shows the series of the security/ stocks, i.e. EQ or BE etc to be traded by traders.

***Total Quantity* –** Here the user has to specify the total quantity or lots to be bought/sell during the session.

***Price* –** The quoted price or desired price at which the shares are to be bought is to be specified normally the anticipated prices or competitive prices are filled by the traders.

***Pro/Client* –** Here the user has to select whether the shares are to be bought in the Proprietor's account or in Client's account depending on the nature of registration with the exchange.

***Client* –** If the shares are to be bought in client's account, the client code has to be specified for the trade and same as modified on real time basis.

***Disclose quantity (DQ)* –** The user/client can disclose a minimum of 10% of the buy/sell quantity of the trade. If nothing is mentioned in the disclose quantity box by client then the entires buy/sell quantity lots or size of trade is disclosed in the market i.e. all the users/ client in the market can see the total quantity for which the order has been entered during trading session.

Validity **-** The user/ client has to choose the validity period for the session from the drop down menu ensuring, DAY (the order will be valid till the end of current day or trading session) and IOC (Immediate or Cancel – Either the order gets executed immediately or gets cancelled if price does not matches on real time basis). IOC order is active in order book for less then 5 microsecond and its removed if un-executed in fractions. Submission of Order – After entering relevant data in all the fields press “Enter and Ctrl” key to submit the order for the present day trade. As the order placed by the client message comes with Time, Order No, Symbol, Series, Quantity, Rate, Member ID, User ID with last word CONFIRMED while entering a trade log.

Circuit Breakers **-** The Exchange is there to facilitate trade and investor, thus it has implemented index-based market-wide circuit breakers in compulsory rolling settlement with effect from July 02, 2001 for carry forwarding the trading session or rollover the position for the next day. In addition to the circuit breakers, price bands are also applicable on individual securities so as to alarm the investor the position to be managed during the session.

Index-based Market-wide Circuit Breakers **-** The NSE guidelines for index-based market-wide circuit breaker system applies at 3 stages of the index movements, either way during the trading session viz. at 10%, 15% and 20%. These circuit breakers when triggered on either side ie. TOP/ BOTTOM bring about a coordinated trading halt in all equity and equity derivative markets nationwide so as to secure the general investors. The market-wide circuit breakers are triggered by movement of either the BSE Sensex or the NSE S&P CNX Nifty, whichever is breached earlier.

- In case of a 10% up/ down movement on either sides of these indices, there would be a one-hour market halt if the movement takes place before 1:00 p.m. In case the upward or downward movement takes place at or after 1:00 p.m. but before 2:30 p.m. there would be trading halt for ½ an hour. In case the movement takes place at or after 2:30 p.m. there will be no trading halt at the 10% level and market shall continue trading the normal way.
- In case of a 15% movement on either side in either index takes place, there shall be a two-hour halt if the movement takes place before 1 p.m. in the market. If the 15% trigger is reached on or after 1:00 p.m., but before 2:00 p.m., there shall be a one-hour halt so as to safeguard the interest of general investors. If the 15% trigger is reached on or after 2:00 p.m. the trading shall halt for remainder of the day i.e. no further trade will take place and the session will end for the trading day.
- In case of a 20% movement of the index, trading shall be halted for the remainder of the day any time during the trading session and the market will remain close.

These percentages are translated into absolute points of index variations on a quarterly basis of the trading carried. At the end of each quarter, these absolute points of index variations are revised by the exchange for the applicability for the next quarter. The absolute points are calculated based on closing level of index on the last day of the trading in a quarter and rounded off to the nearest 10 points in case of S&P CNX Nifty.

Price Bands- Daily price bands are applicable on securities as below: Daily price bands applicable is of 2% (either way) on securities as specified by the Exchange.

- Daily price bands applicable is of 5% (either way) on securities as specified by the Exchange.
- Daily price bands applicable is of 10% (either way) on securities as specified by the Exchange.
- No price bands are applicable on: scrips on which derivative products like futures and options are available or scrips included in indices on which derivative products are available. In order to prevent members from entering orders at non-genuine prices in such securities where derivatives are avaliable, the Exchange has fixed operating range of 20% for such securities.
- Price bands of 20% (either way) on all remaining scrips (including debentures, warrants, preference shares etc).

The price bands for the securities in the Limited Physical Market are the same as those applicable for the securities in the Normal Market. For auction market the price bands of 20% are applicable.

Order Types and Conditions

The system allows the trading members to enter orders with various conditions attached to them as per their requirements. These conditions are broadly divided into Time Conditions, Quantity Conditions, Price Conditions and Other Conditions. Several combinations of the above are allowed thereby providing enormous flexibility to the users. The order types and conditions are summarized below:

a) Time Conditions. DAY - A Day order, as the name suggests, is an order which is valid for the day i.e. intera day trade on which it is entered. If the order is not matched during the entire day trading, the order gets cancelled automatically at the end of the trading day.
IOC - An Immediate or Cancel (IOC) order allows a Trading Member to buy or sell a security as soon as the order is released into the market or punched in the system for trade at the Current Market Price (CMP), failing which the order will be removed from the market instantly. Partial match is possible for the order, and the unmatched portion of the order is cancelled by the exchange immediately.

b) Quantity Conditions Disclosed Quantity (DQ) - An order with a DQ condition allows the Trading Member/ Client trading through NEAT software to disclose only a part of the order quantity to the market. For example, an order of 10000 with a disclosed quantity condition of 2000 will facilitate the trading member that 2000 quantity is displayed to the market at a time. After this is traded and the lot is transferred than, another 2000 is automatically released and so on till the full order is executed. The Exchange may set a minimum disclosed quantity criteria from time to time. MF - Minimum Fill (MF) orders allow the Trading Member to specify the minimum quantity by which an order should be filled.

c) Price Conditions Limit Price/Order – It is a type of order that allows the price to be specified while entering the order into the system for trading.

Market Price/Order – It can be understood as an order to buy or sell securities at the best price obtainable at the time of entering the order during trade.

Stop Loss (SL) Price/Order – The SL is one that allows the Trading Member to place an order which gets activated only when the market price of the relevant security reaches or crosses a threshold price ie Your purchase or short sell prices is out of bound on either sides and you are about to incur loss . Until then the order does not enter the market.

d) Other Conditions PRO/CLI/WHS: A user can enter orders on his own account or on behalf of clients or warehouse order on behalf of institutional clients. By default, the system assumes that the user is entering orders on the trading member's own account.

2. Order Modification

Some times in the moving market during the trading session, orders need to be changed in their prices and quantity as per the requirement and competencies of clients. All the orders can be modified till the time they are not fully executed or the trade is not executed in the name of client. Order modifications can be performed by the following ways:

1. By pressing [F3] [Enter], the Outstanding Order screen appears.
2. On pressing [SHIFT + F2], the Order Modification screen appears along with a white highlight bar on the Outstanding Order screen.
3. Using the arrow keys, the bar can be positioned on the order to be modified and the [ENTER] key is pressed; the details of the selected order get defaulted to the order entry screen.

Condition/Attribute Modification:

1. If a security is not allowed to trade in a particular market then the existing orders under all the securities within that market type are not allowed to be modified.
2. In case the order is modified to a very high quantity that it exceeds the Alert Quantity, set by Exchange, a message will appear on the window pop up.
3. The user is requested to confirm the order by choosing Yes/No. Once he chooses "Yes" the order is confirmed.

4. Orders cannot be modified to a quantity greater than the issued capital for the security.
5. Disclosed quantity orders cannot be modified to such a quantity where the DQ is greater than the order quantity. Further, a DQ order with a value less than one Regular Lot or a value other than multiples of
6. Regular Lot is not permitted.
7. MF orders cannot be modified to a MF quantity greater than the order quantity. If the order also has a DQ condition attached, then the User cannot modify the MF quantity to a value greater than DQ.
8. Additionally, the MF quantity cannot be modified to a value less than one Regular Lot or non-multiples of Regular Lot.

3. Order Cancellation

Due to some problems in moving market either on higher side or falling prices in market or when one does not want to buy or sell shares, then orders need to be canceled. In this case only those orders can be cancelled which have not been fully or partially traded only during market hours or trading session.

Single order procedure can be performed as:

By pressing [F3] [Enter] key, the Outstanding Orders screen will appear.

Press [Shift + F1] key, the order cancellation screen along with a highlight bar will appear or click the left button using mouse.

To cancel the order, this bar can be navigated or positioned by using the [Up/Down, Right / Left] arrow keys.

Once the order to be cancelled is selected, press [ENTER, ENTER & CTRL] key to submit. Press ENTER to select order and other ENTER, CTRL is to send the request.

After cancellation the message come Cancelled by Trader along with Order Number, Symbol, Quantity, Price and User ID all of them appears in message window.

The Order Cancellation screen displays the order details of the selected buy/sell order. A message will be displayed at the bottom of the Order Cancellation screen asking for confirmation to ensure that the correct order has been selected for cancellation.

Press [Enter] key to send the order for cancellation.

Proceed with the cancellation by pressing [Confirm] key. If at this point the User does not want to cancel the order due to any reason, [Esc] key can be used to clear the cancellation screen. The cancelled order gets registered in the operators and an order cancellation slip with a message is generated.

The User also has the option of directly invoking the order cancellation screen by pressing [Shift + F1] and typing the order number. And an alternative to the functional keys is already explained above through the mouse access using the order cancellation icon in the toolbar on the Market Watch screen.

Order Cancellation functionality is available for all book types. But the User is not allowed to cancel auction initials and competitor orders in auction market. Order cancellation is also not allowed for those negotiated trade orders that have not resulted as an alert.

4. Order Matching

The buy and sell orders are matched on Book Type, Symbol, Series, Quantity and Price.

a) Matching Priority-priority can be done on the basis of price and time.

b) Regular Lot Matching

If the combined quantity of one or more matching orders on the opposite side of the regular lot book is equal to or less than the quantity of active order, the active order is partially traded. If after trading any quantity is left untraded, the order is added to the regular lot book in the price/time priority. The orders with the IOC attribute try to match maximum possible quantity after they are entered. Any remaining quantity is cancelled.

Trade Management

A trade is an activity in which a buy and a sell order match with each other meaning that the price quoted by client matches the CMP. Matching of two orders is done automatically by the NEAT system. Whenever a trade takes place, the system sends a trade confirmation message to each of the users involved in the trade during the trading session. The trade confirmation slip gets printed at the trader workstation of the user with a unique trade number get his open or closed position of trade. The system also broadcasts a message to the entire market through the ticker window displaying the details of the trade.

Trade Modification

The user can use trade modification facility or can change the order placed by them to request for modifying trades done during the day. The user can request the Exchange to modify only the trade quantity field any time during the trading session. Moreover, the new quantity requested must be lower than the original trade quantity.

Cancellation

The user can use trade cancellation screen for cancelling trades done during the day. If the user is a corporate manager of a trading member firm, he can request for trade cancellation for the trades of any dealer of the trading members firm and if he is a branch manager of a branch, then he can request for trade cancellation for the trades for any dealer of the branch of the trading member firm.

Auction

Auctions are initiated by the Exchange on behalf of trading members for settlement related reasons. The main reasons are Shortages, Bad Deliveries and Objections. There are three types of participants in the auction market.

(a) Initiator: The party who initiates the auction process is called an initiator.

(b) Competitor: The party who enters on the same side as of the initiator is called a competitor.

(c) Solicitor: The party who enters on the opposite side as of the initiator is called a solicitor.

The trading members can participate in the Exchange initiated auctions by entering orders as a solicitor. E.g. If the Exchange conducts a Buy-In auction, the trading members entering sell orders are called solicitors.

When the auction starts, the competitor period for that auction also starts on parallel basis. Competitor period is the period during which competitor order entries are allowed in the extra trading session. Competitor orders are the orders which compete with the initiator's order i.e. if the initiator's order is a buy order, then all the buy orders for that auction other than the initiator's order are competitor orders. And if the initiator order is a sell order then all the sell orders for that auction other than the initiators order are competitor orders considered for trade.

After the competitor period ends, the solicitor period for that auction starts. Solicitor period is the period during which solicitor order entries are allowed to trade and balance the difference in quantity. Solicitor orders are the orders which are opposite to the initiator order i.e. if the initiator order is a buy order, then all the sell orders for that auction are solicitor orders and if the initiator order is a sell order, then all the buy orders for that auction are solicitor orders.

After the solicitor period, order matching takes place. The system calculates trading price for the auction and all possible trades for the auction are generated at the calculated trading price. After this the auction is said to be complete. Competitor period and solicitor period for any auction are set by the Exchange.

Auction Market (AU) Orders:

The term AU stands for Auction in which orders are entered for Auction Market. Auctions are initiated by the Exchange on behalf of trading members for settlement related reasons. The main reasons are Shortages, Bad Deliveries and Objections. The auction period is initiated at 12:00 P.M to 12:30 P.M. The matching process for auction orders in this book is initiated only at the end of the auction period. The auction ending period is between 12:30 P.M. and 1 P.M.

7.7 Auction in RETDEEBT Market

- **Entering Auction Orders:**

Auction order entry allows the user to enter orders into auctions that are currently running during the trading period. To view the information about currently running auctions invoke ‘Auction Enquiry’ screen. The user can do auction order entry by entering ‘AU’ in the book type of the order entry screen. Symbol and Series that is currently selected in any of the market information windows (i.e. MW) provides the defaults in the auction order entry screen.

- **Auction Order Modification:**

The user is not allowed to modify any auction orders during the trading session.

- **Auction Order Cancellation:**

The user can cancel any solicitor order placed by him in any auction provided the solicitor period for that auction is not over. The order cancellation procedure is similar to that of normal market. The user can also use quick order cancellation key to cancel his outstanding auction orders.

- **Auction Order Matching:**

When the ‘solicitor period’ for an auction is over, auction order starts matching for that auction. During this process, the system calculates the trading price for the auction based on the initiator order and the orders entered during the competitor and the solicitor period. At present for Exchange initiated auctions, the matching takes place at the respective solicitor order prices. The name of the company can be over written in all types of orders.

- **Limited Physical Market**

Pursuant to the directive of SEBI to provide an exit route for small investors holding physical shares in securities mandated for compulsory dematerialised settlement, the Exchange has provided a facility for such trading in physical shares not exceeding 500 shares. This market segment is referred to as 'Limited Physical Market' (small window). The Limited Physical Market was introduced on June 7, 1999.

7.8 Summary

This unit will provide a deep inside about retail debt market other than equity shares which is a good source of investment. RETDEBT is an upcoming investment avenue and it has its own features. There is a separate trading concepts and features of this market. Investors can also make use of this market as a new source of generating income for them.

7.9 Self Assessment Questions

1 Explain the types of order books are present in the trading system?
2 Discuss the circuit breakers.
3 What do you understand from the order types & various conditions attached to it?
4 Explain in detail about order modification.
5 Detail the procedures followed to cancel orders for a disabled member?
6 What is order matching on priority basis? How stop loss orders are matched?
7 What is auction? How it is initiated?

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Unit : 8 - Depository System & Depositories ACT, 1996

Structure of Unit:

8.0 Objectives

This Unit is designed to enable the student to understand:

- Basic concept of Depository
- Depository participants, functions rights and obligations of depositories
- Benefits of depositories, dematerialisation process, and
- Regulatory framework for depository in India.

8.1 Introduction

The inception of depository System in the Indian Capital market has been during the 90's. The depositories are an important intermediaries in the securities market that is scrip-less or moving towards such a state. The erstwhile settlement system on Indian stock exchanges involved movement of paper securities to the issuer for registration, with the change of ownership being evidenced by an endorsement on the security certificate. Theft, forgery, mutilation of certificates and other irregularities provided the issuer right to refuse the transfer of a security. Added costs and delays in settlement, restricted liquidity and made investor grievance redressal time–consuming. To obviate these problems, the Depositories Act,1996 was passed and subsequently the regulations were notified.

A Depository is an organization like a Central Bank where the securities of a shareholder are held in the electronic form at the request of the shareholder through the medium of a Depository Participant. To utilize the services offered by a Depository, the investor has to open an account with the Depository through a Depository Participant.

According to Section 2(e) of the Depositories Act, 1996. "Depository means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under Section 12(1A) of the SEBI Act, 1992". A depository cannot act as a depository unless it obtains a certificate of commencement of business from SEBI.

There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL). Under the provisions of the Depositories Act, these Depositories provide various services to investors and other Participants in the capital market, such as, clearing members, stock exchanges, investment institutions, banks and issuing corporate. These include basic facilities like account opening, dematerialization, dematerialization, settlement of trades and advanced facilities like pledging, distribution of non-cash corporate actions, distribution of securities to allottees in case of public issues, etc.

All the securities held by a depository shall be dematerialized and shall be in a fungible form. To utilize the services offered by a depository, the investor has to open an account with the depository through a participant, similar to the opening of an account with any of the bank branches to utilize services of that bank. Registration of the depository is required under SEBI (Depositories and Participants) Regulations, 1996 and is a precondition to the functioning of the depository. Depository and depository participant both are regulated by SEBI.

Both depository and custodial services are responsible for safe keeping of securities but they are different in the sense that the Depository can legally transfer beneficial ownership, which a custodian cannot. The main objective of a Depository is to minimize the paper work involved with the ownership, trading and transfer of securities.

8.2 Benefits of Depository System

In the depository system, the ownership and transfer of securities takes place by means of electronic book entries. At the outset, this system rids the capital market of the dangers related to handling of paper. The system provides numerous direct and indirect benefits, like:

- **Elimination of bad deliveries**- In the depository environment, once holdings of an investor are dematerialised, the question of bad delivery does not arise i.e. they cannot be held "under objection". In the physical environment, buyer of shares was required to take the risk of transfer and face uncertainty of the quality of assets purchased. In a depository environment good money certainly begets good quality of assets.
- **Elimination of all risks associated with physical certificates** – Dealing in physical securities have associated security risks of theft of stocks, mutilation of certificates, loss of certificates during movements through and from the registrars, thus exposing the investor to the cost of obtaining duplicate certificates and advertisements, etc. This problem does not arise in the depository environment.
- **Immediate transfer and registration of securities** – In the depository environment, once the securities are credited to the investors account on pay out, he becomes the legal owner of the securities. There is no further need to send it to the company's

registrar for registration. Having purchased securities in the physical environment, the investor has to send it to the company's registrar so that the change of ownership can be registered. This process usually takes around three to four months and is rarely completed within the statutory framework of two months thus exposing the investor to opportunity cost of delay in transfer and to risk of loss in transit. To overcome this, the normally accepted practice is to hold the securities in street names i.e. not to register the change of ownership. However, if the investors miss a book closure the securities are not good for delivery and the investor would also stand to lose his corporate entitlements.

- **Faster disbursement of non cash corporate benefits like rights, bonus, etc.** – Depository system provides for direct credit of non cash corporate entitlements to an investors account, thereby ensuring faster disbursement and avoiding risk of loss of certificates in transit.
- **Reduction in brokerage by many brokers for trading in dematerialized securities**– Brokers provide this benefit to investors as dealing in dematerialized securities reduces their back office cost of handling paper and also eliminates the risk of being the introducing broker.
- **Reduction in handling of huge volumes of paper and periodic status reports to investors on their holdings and transactions, leading to better controls.**
- **Elimination of problems related to change of address of investor, transmission, etc.** – In case of change of address or transmission of demat shares, investors are saved from undergoing the entire change procedure with each company or registrar. Investors have to only inform their DP with all relevant documents and the required changes are effected in the database of all the companies, where the investor is a registered holder of securities.
- **Elimination of problems related to selling securities on behalf of a minor-** A natural guardian is not required to take court approval for selling demat securities on behalf of a minor.

8.3 Depository System-An Overview

The Depository System functions very much like the banking system. A bank holds funds in accounts whereas a Depository holds securities in accounts for its clients. A Bank transfers funds between accounts whereas a Depository transfers securities between accounts. In both systems, the transfer of funds or securities happens without the actual handling of funds or securities. Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively.

In the depository system, share certificates belonging to the investors are to be dematerialized and their names are required to be entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies' register are replaced by the name of depository as the registered owner of the securities. The depository, however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial owner continues to enjoy all the rights and benefits and is subject to all the liabilities in respect of the securities held by a depository. Shares in the depository mode are fungible and cease to have distinctive numbers. The transfer of ownership changes in the depository is done automatically on the basis of delivery v. payment.

In the Depository mode, corporate actions such as IPOs, rights, conversions, bonus, mergers/amalgamations, subdivisions & consolidations are carried out without the movement of papers, saving both cost & time. Information of beneficiary owners is readily available. The issuer gets information on changes in shareholding pattern on a regular basis, which enables the issuer to efficiently monitor the changes in shareholdings.

The Depository system links the issuing corporates, Depository Participants (DPs), the Depositories and clearing corporation/ clearing house of stock exchanges. This network facilitates holding of securities in the soft form and effects transfers by means of account transfers. Following presentation about depositories reveal all about depositories, its concepts and trading, i.e. models of depositories, Depository functions, Legal linkage, depository participant, Registrars and issuers, dematerialisation, rematerialisation, electronic credit in new issues, trading system, corporate action.

8.3.1 Models of Depository

- **Immobilisation –** Where physical share certificates are kept in vaults with the depository for safe custody. Allsubsequent transactions in these securities take place in book entry form. The actual owner has the right to withdraw his physical securities as and when desired. The immobilization of fresh issue may be achieved by issuing a jumbo certificate representing the entire issue in the name of depository, as nominee of the beneficial owners.
- **Dematerialisation** – No Physical scrip in existence, only electronic records maintained by depository. This type of system is cost effective and simple and has been adopted in India. Dematerialization is a process by which the physical share certificates of an investor are taken back by the Company and an equivalent number of securities are credited his account in electronic form at the request of the investor. An investor will have to first open an account with a Depository Participant and then request for the dematerialization of his share certificates through the Depository Participant so that the dematerialized holdings can be credited into that account. This is very similar to opening a Bank Account. Dematerialization of shares is optional and an investor can still hold shares in physical form. However, he/she has to demat the shares if he/she wishes to sell the same through the Stock Exchanges. Similarly, if an investor purchases shares from the Stock Exchange, he/she will get delivery of the shares in demat form. Odd lot share certificates can also be dematerialized.

- **Depository Functions**

  – Account opening

  – Dematerialisation

  – Rematerialisation

  – Settlement

  – Initial Public Offers (IPO's), corporate benefits

  – Pledging

- **Depository Participant**

Just as a brokers act an agent of the investor at the Stock Exchange; a Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository. The Depository Participant maintains securities account balances and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, Financial Institutions like banks, custodians, stockbrokers etc. can become participants in the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the Depository can be compared to a Bank, DP is like a branch of that bank with which an account can be opened. The main characteristics of a depository participant are as under:

  – Acts as an Agent of Depository

  – Customer interface of Depository

  – Functions like Securities Bank

  – Account opening

  – Facilitates dematerialisation

  – Instant transfer on pay-out

  – Credits to investor in IPO, rights, bonus

  – Settles trades in electronic segment

- **Registrar**

  – Dematerialisation

  – Confirmation of Beneficiary Holdings

  – Corporate Actions – Rights, Bonus, etc.

  – Reconciliation of Depository Holdings

  – Rematerialisation

- **Dematerialisation**

  – Investor opens account with DP

  – Fills Dematerialisation Request Form (DRF) for registered shares

  – Investor lodges DRF and certificates with DP

  – DP intimates the Depository

  – Depository intimates Registrar/Issuer

  – DP sends certificates and DRF to Registrar/Issuer

  – Registrar/Issuer confirms demat to Depository

  – Depository credits investor a/c

- **Rematerialisation**

  – Client submits Rematerialisation Request Form (RRF) to DP

  – DP intimates Depository

  – Depository intimates the Registrar/Issuer

  – DP sends RRF to the Registar/Issuer

  – Registrar/Issuer prints certificates and sends to Investor

  – Registrar/Issuer confirms remat to Depository

  – Investor's account with DP debited

- **Electronic Credit in New Issues**

  – Investor opens account with DP

  – Submits application with option to hold securities in depository giving DP-Id and Client-Id

  – Registrar uploads list of allottees to Depository

  – Depository credits allottee's account with DP

  – Refunds sent by Registrar as usual

- **Trading System**

  – Separate quotes in Book Entry

  – Trading Member to have Clearing Account with DP

  – Settlement as per Settlement Calendar of Stock Exchange

  – Trading can be introduced in any Stock exchange if settlement is guaranteed

- **Corporate Actions**

  – Dividends/cash benefits – these benefits are directly forwarded to the investors by the company or its registrar and transfer agent.

  – Non-cash benefits, viz. Bonus, Rights Issue, etc. – these benefits are electronically credited to the beneficial owner's account through Depository.

- **Legal Framework**

  The legal framework for a depository system has been laid down by the Depositories Act, 1996 and is regulated by SEBI. The depository business in India is regulated by –

  – The Depositories Act, 1996

  – The SEBI (Depositories and Participants) Regulations, 1996

  – Bye-laws of Depository

  – Business Rules of Depository.

  Apart from the above, Depositories are also governed by certain provisions of:

  – The Companies Act, 1956

  – The Indian Stamp Act, 1899

  – Securities and Exchange Board of India Act, 1992

  – Securities Contracts (Regulation) Act, 1956

  – Benami Transaction (Prohibition) Act, 1988

  – Income Tax Act, 1961

  – Bankers' Books Evidence Act, 1891

The legal framework for depository system in the Depositories Act, 1996 provides for the establishment of single or multiple depositories. Anybody to be eligible for providing depository services must be formed and registered as a company under the Companies Act, 1956 and seek registration with SEBI and obtain a Certificate of Commencement of Business from SEBI on fulfillment of the prescribed conditions. The investors opting to join depository mode are required to enter into an agreement with depository through a participant who acts as an agent of depository. The agencies such as custodians, banks, financial institutions, large corporate brokerage firms, non-banking financial companies etc. act as participants of depositories. The companies issuing securities are also required to enter into an agreement with the Depository.

8.4 The Depositories Act, 1996

Objectives

- The depositories legislation as per the Statement of Objects and Reasons appended to the Depositories Act, 1996 aims at providing for:
- A legal basis for establishment of depositories to conduct the task of maintenance of ownership records of securities and effect changes in ownership records through book entry;
- Dematerilisation of securities in the depositories mode as well as giving option to an investor to choose between holding securities in physical mode and holding securities in a dematerialized form in a depository;
- Making the securities fungible;
- Making the shares, debentures and any interest thereon of a public limited company freely transferable; and
- Exempting all transfers of shares within a depository from stamp duty.

Eligibility Condition for Depository Services

Any company or other institution to be eligible to provide depository services must:

– be formed and registered as a company under the Companies Act, 1956.

– be registered with SEBI as a depository under SEBI Act, 1992.

– has framed bye-laws with the previous approval of SEBI.

– has one or more participants to render depository services on its behalf.

– has adequate systems and safeguards to prevent manipulation of records and transactions to the satisfaction of SEBI.

– complies with Depositories Act, 1996 and SEBI (Depositories and Participants) Regulations, 1996.

– meets eligibility criteria in terms of constitution, network, etc.

Eligible Securities Required to be in the Depository Mode

Section 8 of the Depositories Act gives the option to the investors to receive securities in physical form or in depository mode. It is not necessary that all eligible securities must be in the depository mode. In the scheme of the Depositories legislation, the investor has been given supremacy. The investor has the choice of holding physical securities or opt for a depository based ownership record. However in case of fresh issue of securities all securities issued have to be in dematerialized form. However after that investor will also have the freedom to switch from depository mode to non-depository mode and vice versa. The decision as to whether or not to hold securities within the depository mode and if in depository mode, which depository or participant, would be entirely with the investor.

Fungibility

Section 9 states that securities in depositories shall be in fungible form. The Act envisages that all securities held in depository shall be fungible i.e. all certificates of the same security shall become interchangeable in the sense that investor loses the right to obtain the exact certificate he surrenders at the time of entry into depository. It is like withdrawing money from the bank without bothering about the distinctive numbers of the currencies.

Immobilisation of securities in a depository mode refers to a situation where the depository holds securities in the form of physical paper side by side with electronic evidence of ownership. In such a case the transfers are not accompanied by physical movement of securities but securities are in existence in the custody of the depository. However, the Depositories Act, envisages dematerialisation in the depository mode. In such a case the securities held in a depository shall be dematerialized and the ownership of the securities shall be reflected through book entry only. The securities outside the depository shall be represented by physical scrips. Hence, the depository legislation envisages partial dematerialisation, i.e. a portion of the securities in dematerialized form and the other portion in physical form. Sections 153, 153A, 153B, 187B, 187C and 372 (now 372A) of Companies Act, 1956 shall not apply to a depository in respect of shares held on behalf of beneficial owners in depositories.

Rights of Depositories and Beneficial Owner

A depository should be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. The depository as a registered owner should not have any voting rights or any other rights in respect of securities held by it. The beneficial owner is entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

Register of Beneficial Owner

Every depository is required to maintain a register and an index of beneficial owners in the manner provided in the Companies Act.

Pledge or Hypothecation of Securities Held in a Depository

A beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository. Every beneficial owner should give intimation of such pledge or hypothecation to the depository participant and such depository is required to make entries in its records accordingly. Any entry in the records of a depository should be evidence of a pledge or hypothecation.

Furnishing of Information and Records by Depository and Issuer

Every depository shall furnish to the issuer information about the transfer of securities in the name of beneficial owners at such intervals and in such manner as may be specified by the bye-laws. Every issuer shall make available to the depository copies of the relevant records in respect of securities held by such depository.

Option to Opt Out in Respect of any Security

Section 14 of the Act provides that if a beneficial owner seeks to opt out of a depository in respect of any security he should inform the depository accordingly. After the receipt of intimation the depository should make appropriate entries in its records and also inform the issuer. Every issuer may, within thirty days of the receipt of intimation from the depository and on fulfillment of such conditions and on payment of such fees as may be specified by the regulations, issue the certificate of securities to the beneficial owner or the transferee, as the case may be.

Depositories to Indemnify Loss in Certain Cases

Any loss caused to the beneficial owner due to the negligence of the depository or the participant, would be indemnified by the depository to such beneficial owner. Where the loss due to the negligence of the participant is indemnified by the depository, the depository has the right to recover the same from such participant.

Power of SEBI

Section 18 of the Act provides that SEBI in the public interest or in the interest of investors may by order in writing to call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require; or authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

Sub-section (2) to Section 18 provides that every director, manager, partner, secretary, officer or employee of the depository or issuer or the participant or beneficial owner shall on demand produce before the person making the enquiry or inspection all information or such records and other documents in his custody having a bearing on the subject matter of such enquiry or inspection.

If after making or causing to be made an enquiry or inspection, SEBI is satisfied that it is necessary in the interest of investors, or orderly development of securities market; or to prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or securities market, SEBI may issue such directions to any depository or participant or any person associated with the securities market; or to any issuer as may be appropriate in the interest of investors or the securities market.

Power of SEBI to give Directions

Section 19 provides that SEBI after making an enquiry or inspection and if satisfied may issue appropriate directions (a) to any depository or participant or any person associated with the securities market; or (b) to any issuer in the interest of investors or the securities market or to prevent the affairs of any depository or participant being conducted in the manner detrimental to the interests of investors or the securities market.

Penalty for Failure to Furnish Information/Return Etc.

Section 19A provides that any person, who is required under Depositories Act or any rules or regulations or bye-laws made there under –

(a) to furnish any information, document, books, returns or report to the Board, fails to furnish the same within the time specified there for fails to furnish the same within specified time;

(b) to file any return or furnish any information, books or other documents within the time specified there for in the regulations or bye-laws, fails to file return or furnish the same within the time specified there for, fails to file such return or furnish the required information within the specified time;

(c) to maintain books of account or records, fails to maintain the same; he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for Failure to Enter into Agreement

Section 19B provides that if a depository or participant or any issuer or its agent or any person, who is a registered intermediary and is required under this Act or any rules or regulations made there under, to enter into an agreement, fails to enter into such agreement, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less for every such failure.

Penalty for Failure to Redress Investors' Grievances

Section 19C provides that if any depository or participant or any issuer or its agent or any person, who is registered as a registered intermediary, after having been called upon by the SEBI in writing, to redress the grievances of the investors, fails to redress such grievances within the time specified, such depository or participant or issuer or its agents or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for Delay in Dematerialisation or Issue of Certificate of Securities

Section 19D provides that if any issuer or its agent or any person, who is a registered intermediary, fails to dematerialise or issue the certificate of securities on opting out of a depository by the investors, within the time specified under this Act or regulations or bye-laws made there under or abets in delaying the process of dematerialisation or issue the certificate of securities on opting out of a depository of securities, such intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Power to Adjudicate

Section 19H provides that for the purpose of adjudging SEBI shall appoint any officer not below the rank of a Division Chief of SEBI to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty. While holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in this Act, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.

Factors to be taken into Account by Adjudicating Officer

Section 19 I requires that while adjudging the quantum of penalty under section 19H, the adjudicating officer shall have due regard to the following factors, namely–(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default; (b) the amount of loss caused to an investor or group of investors as a result of the default; (c) the repetitive nature of the default.

Crediting of Penalties

Section 19J provides that all sums realised by way of penalties under this Act shall be credited to the Consolidated Fund of India.

Offences

Section 20 provides that without prejudice to any award of penalty by the adjudicating officer under this Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations or bye-laws made there under, he shall be punishable with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both. If any person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years, or with fine, which may extend to twenty-five crore rupees, or with both.

Power to Grant Immunity

Section 22B empowers the Central Government to grant immunity, on recommendation by the Board, if the Central Government is satisfied, that any person, who is alleged to have violated any of the provisions of this Act or the rules or the regulations made there under, has made a full and true disclosure in respect of alleged violation, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act, or the rules or the regulations made there under or also from the imposition of any penalty under this Act with respect to the alleged violation. No such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity. Recommendation of the Board under this sub-section is not binding upon the Central Government.

The immunity granted to a person may, at any time, be withdrawn by the Central Government, if it is satisfied that such person had, in the course of the proceedings, not complied with the condition on which the immunity was granted or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Appeal to Securities Appellate Tribunal

Section 23A provides that, any person aggrieved by an order of SEBI or by an adjudicating officer under this Act may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter. However, no appeal shall lie to the Securities Appellate Tribunal from an order made by SEBI with the consent of the parties. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by SEBI is received by the person and it shall be in such form and be accompanied by such fee as may be prescribed:

Provided that the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period. On receipt of an appeal, the Securities Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against. The Securities Appellate Tribunal shall send a copy of every order made by it to SEBI and parties to the appeal. The appeal filed before the Securities Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

Appeal to Supreme Court

Section 23F provides that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of law arising out of such order. Provided that the Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Civil Court not to have Jurisdiction

Section 23 E provides that No Civil Court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which a Securities Appellate Tribunal is empowered by or under this Act to determine and no injunction can be granted by any court or other authority in respect of any action taken or to be taken. In pursuance of any power conferred by or under this Act.

Areas on Which Rules may be Framed by The Central Government

The Central Government under Section 24, may frame Rules to provide, inter alia, for:

– the manner of inquiry under Section 19H(1).

– the time within which an appeal may be preferred from the orders of SEBI under Section 23(1).

– the form in which an appeal may be preferred and the fees payable in respect of such appeal.

– the procedure for disposing of an appeal.

– the form in which an appeal may be filed before the Securities Appellate Tribunal under Section 23A and the fees payable in respect of such appeal.

Power of SEBI to make Regulations

Section 25 of the Depositories Act, 1996 read with Section 30 of SEBI Act, 1992 empowers SEBI to make regulations for carrying out the purposes of the Act, by notification in the Official Gazette. The regulations may, inter alia, provide for:

i. The requirements to be complied with by a person for seeking registration as a Depository with SEBI under SEBI Act, 1992.

ii. The requirements for registration of a person as a participant under SEBI Act.

iii. Determination of any form in which records may be maintained by a Depository. As per Section 2(1)(i) of the Act, 'record' includes the records maintained in the form of books or stored in a computer or in such other form as may be determined by regulations.

iv. The requirements for grant of certificate of commencement of business by depositories and the form in which the certificate of commencement of business has to be issued.

v. The manner in which the certificate of security shall be surrendered to the issuer by any investor who is desirous of availing depository services.

vi. The manner in which the issuer has to cancel the certificates of securities received by it for cancellation and its intimation to the depository.

vii. The manner in which the depository has to register transfer of security in the name of the transferee on receipt of the intimation from a participant and where the beneficial owner or a transferee seeks to have custody of security, the manner in which the depository shall inform the issuer.

viii. Where a person opts to hold a security with a depository in the event of a public issue, the manner in which the issuer is required to intimate the depository the details of allotment of the security.

ix. The requirements to be complied with by a beneficial owner for creating with the previous approval of depository, pledge or hypothecation in respect of a security owned by him through depository.

x. The conditions and the fees payable with respect to the issue of certificate of securities to the beneficial owner where the beneficial owner seeks to opt out of the depository.

xi. The rights and obligations of the depositories, participants, and the issuers whose securities are dealt with by a depository.

xii. The eligibility criteria for admission of securities into the depository.

Evidenciary Value of the Records of the Depository

Section 15 of the Act treats depository as a bank for the purposes of the Bankers' Books Evidence Act, 1891. The ownership records of securities maintained by depositories, whether maintained in the form of books or machine readable forms, shall be accepted as prima facie evidence in all legal proceedings.

SEBI (Depositories and Participants) Regulations, 1996

The Depositories Act requires that the registration of the depository, depository participant and the custodian, is mandatory with the Securities and Exchange Board of India. These market intermediaries can function or commence business only after registration from SEBI has been obtained and requisite fee paid to SEBI. The requirement of registration is a continuing one and the moment the registration is cancelled or revoked or surrendered, the person shall cease to act as such.

SEBI had issued SEBI (Depositories and Participants) Regulations, 1996 on 16th May, 1996 which apply to depositories and its participants. These regulations also contain provisions for operations and functioning of depositories, form for application and certificates used and schedule of fees for participants, etc. It also contains provisions for registration of depository and depository participants, rights and obligations of various users and constituents, inspection and procedure for action in case of default.

Entities desiring to become depository participants must apply to the depository and are required to be recommended to SEBI by the depository. If approved and registered by SEBI, the depository participant can be admitted on the depository. The depository has to formulate its own set of criteria for selection of participants.

Every participant holding a certificate is required at all times to abide by the specified Code of Conduct. The regulations require the depository to list out, through its Bye-laws, the securities which are eligible to be admitted to the depository for dematerialization. Equity shares, debentures, warrants, bonds, units of mutual funds, etc. are part of the list of eligible securities. The depository is empowered to set its own criteria for selection of securities and make securities eligible to be maintained in the form of electronic holdings on the depository.

Further, the regulations stipulate that agreements should be entered into by the following entities:

– depository and every participant
– participant and every client
– depository, issuer company and the Registrar

The draft of these agreements is to be included in the Bye-laws and to be approved by SEBI. The depository is required to ensure that sufficient safeguards are in place to protect the data available with it and with the participants. To reduce risk in operations, the regulations stipulate that adequate insurance cover be provided by the depository and by the depository participants as well. The regulations also require for reconciliation to be carried out on a daily basis. Further, the depository and the registrar will also reconcile balances on a daily and a periodic basis.

Rights and Obligations of Depositories and its Constituents

This Regulations deal with rights and obligations of depositories and every depository has to state in its bye-laws the eligible securities for dematerialisation which include shares, scrips, stock, bonds, debentures stock, etc., and include units of mutual funds, rights under collective investment schemes and venture capital funds, commercial paper, certificate of deposit, securitised debt, money market instruments and even unlisted securities.

Every depository is required to enter into an agreement with the issuer in respect of securities disclosed as eligible to be held in demat form. No agreement is required to be entered into where the depository itself is an issuer of securities. The depository is also required to enter into a tripartite agreement with the issuer, its transfer agent and itself where company has appointed a transfer agent. Every depository is required to maintain continuous connectivity with issuers, registrars and transfer agents, participants and clearing house or clearing corporations. Depositories should take adequate measures including insurance to protect the interest of the beneficial owners.

Every depository is required to maintain the following records and documents namely:

– records of securities dematerialised and rematerialised;
– the names of the transferor, transferee, and the dates of transfer of securities;
– a register and an index of beneficial owners;
– details of holding of the securities of the beneficial owners as at the end of the each day;
– records of instruction(s) received from and sent to participants, issuers' agents and beneficial owners;
– records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be;
– details of participants;
– details of securities declared to be eligible for dematerialisation in the depository;

Every depository has to intimate SEBI the place where the records and documents are maintained. Subject to the provisions of any other law, the depository shall preserve records and documents for a minimum period of five years.

Participants are required to enter into an agreement with beneficial owners. It is required that separate accounts are to be opened by every participant in the name of each of the beneficial owner and the securities of each beneficial owners are to be segregated and shall not be mixed up with the securities of other beneficial owners or with the participant's own securities. The participants are obliged to reconcile the records with every depository on a daily basis. Participants are required to maintain the following records for a period of five years–

– records of all the transactions entered into with a depository and with a beneficial owner;

– details of security dematerialised, rematerialised on behalf of beneficial owners with whom it has entered into an agreement;

– records of instructions received from beneficial owners and statements of account provided to beneficial owners; and

– records of approval, notice, entry and cancellation of pledge or hypothecation as the case may be.

Governance of Depository

Governing Board, Disclosures and Corporate Governance-This regulations deal with the composition of Governing board of a Depository.

– The governing board of every depository is required to include:

  (a) shareholder directors;

  (b) public interest directors; and

  (c) managing director.

– Any employee of a depository may be appointed on the governing board in addition to the managing director, and such director shall be deemed to be a shareholder director.

– The chairperson shall be elected by the governing board from amongst the public interest directors Subject to prior approval of SEBI.

– The number of public interest directors shall not be less than the number of shareholder directors in a depository.

– The managing director shall be an ex-officio director on the governing board and shall not be included in either the category of public interest directors or shareholder directors.

The disclosure requirements and corporate governance norms as specified for listed companies shall mutatis mutandis apply to a depository.

Investor Protection Fund

Every depository is required to establish and maintain an Investor Protection Fund for the protection of interest of beneficial owners. Every depository should credit twenty five per cent of its profits every year to the Investor Protection Fund. Audit Under SEBI(Depositories and Participants) Regulations, 1996.

Regulation 55A of SEBI (Depositories and Participants) Regulations, 1996 provides that every issuer shall submit audit report on a quarterly basis to the concerned stock exchanges audited by a practicing Company Secretary or a qualified Chartered Accountant, for the purposes of reconciliation of the total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital.

The audit report is required to give the updated status of the register of members of the issuer and confirm that securities have been dematerialized as per requests within 21 days from the date of receipt of requests by the issuer and where the dematerialization has not been effected within the said stipulated period, the report would disclose the reasons for such delay. The issuer is under an obligation to immediately bring to the notice of the depositories and the stock exchanges, any difference observed in its issued, listed, and the capital held by depositories in dematerialized form.

Internal Audit of Operations of DPs

The two Depository service providers in India, viz., National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Limited (CDS) notified amendment of its Bye Law 10.3.1 of Chapter 10 as follows: 10.3.1 “Every Participant shall ensure that an internal audit in respect of the operations of the Depository is conducted at intervals of not more than three months by a qualified Chartered Accountant or a Company Secretary holding a certificate of Practice and a copy of the internal audit report shall be furnished to the Depository.”

Concurrent Audit

National Securities Depository Limited vide its Circular No. NSDL/POLICY/ 2006/0021 dated June 24, 2006 provides for concurrent audit of the Depository Participants. The Circular provides that w.e.f. August 1, 2006, the process of demat account opening, control and verification of Delivery Instruction Slips (DIS) is subject to Concurrent Audit. Depository Participants have been advised to appoint a firm of qualified Chartered Accountant(s) or Company Secretary(ies) holding a certificate of practice for conducting the concurrent audit. However, the participants in case they so desire, may entrust the concurrent audit to their Internal Auditors.

Establishment of Connectivity with NSDL and CDSL

To enhance the efficiency of the stock market, rolling settlement were introduced by SEBI. The stocks which were not compulsory rolling settlement were traded under compulsory rolling settlement. To facilitate the settlement, SEBI prescribed the compulsory dematerialized trading by companies through connectivity with both the depositories NSDL and CDSL.

The stock exchanges may consider shifting the trading of securities of the Companies who have established connectivity with both the depositories to rolling settlement subject to the following:

(a) At least 50% of non-promoter holdings as per clause 35 of Listing Agreement are in demat mode before shifting the trading in the securities of the company from Trade for Trade Segment (TFTS) to Rolling settlement. For this purpose, the listed companies are required to obtain a certificate from its Registrar and Transfer Agent (RTA) and submit the same to the stock exchange/s. However, if an issuer-company does not have a separate RTA, it may obtain a certificate in this regard from a practicing Company Secretary/Chartered Accountant and submit the same to the stock exchange/s.

(b) There are no other grounds/reasons for continuation of the trading in TFTS.

The Stock Exchanges are also required to report to SEBI, the action taken in this regard in their Monthly/ Quarterly Development Report.

Basic Services Demat Account (BSDA)

With a view to achieve wider financial inclusion, encourage holding of demat accounts and to reduce the cost of maintaining securities in demat accounts for retail individual investors, SEBI introduced the concept of basic services demat account (BSDA). All depository participants (DPs) shall make available a "Basic Services Demat Account" (BSDA) with limited services and reduced costs compared to conventional demat accounts. These BSDA will also offer SMS alert facility for debit transactions.

Eligible Investor

The “Basic Services Demat Account” (BSDA) promises to provide limited services at reduced costs to retail investors. All individual who currently have one account or plan to open an demat account where they are the sole first holder will be allowed to open the BSDA, provided that the value of securities held will not be more than `2 lakh at any given point of time. However, Investors can open only one BSDA across all DPs. An existing eligible individual who holds a demat account with a DP can convert demat account into BSDA on the date of the next billing cycle based on value of holding of securities as on the last day of previous billing cycle.

Charges

The Annual Maintenance Charges (AMC) which will have to pay for BSDA will be as per predetermined slabs. If the value of holdings is up to `50,000 there won't be any annual maintenance charge. However, if the value of holding is in between `50,001 to `200,000, a fee of `100 as AMC may be charged. If the value of holdings exceeds, DPs are permitted to charge the same as they charge non- BSDA regular demat accounts.

Valuation of Holding

The value of holding shall be determined on the basis of the daily closing price or Net Asset Value of the securities or units of mutual funds. Where such price is not available the last traded price may be taken into account and for unlisted securities other than units of mutual funds, face value may be taken in to account.

Statements

(a) Transaction statements:

(a) Transaction statements shall be sent to the BO at the end of each quarter. If there are no transactions in any quarter, no transaction statement may be sent for that quarter.

(b) If there are no transactions and no security balance in an account, then no further transaction statement needs to be provided.

(c) Transaction statement shall be required to be provided for the quarter in which the account became a zero balance account.

(b) Holding Statement:

(a) One annual physical statement of holding shall be sent to the stated address of the BO in respect of accounts with no transaction and nil balance.

b) One annual statement of holding shall be sent in respect of remaining accounts in physical or electronic form as opted for by the BO.

Electronic statements shall be provided free of cost. However, for physical statements, DPs have to provide two statements free of cost to the account holder during the billing cycle. But additional statements will be charged a fee, which cannot be more than `25. Holder will get a transaction statement at the end of every quarter, provided there has been at least a single transaction in the quarter. For accounts where there are transactions, account holder will get an annual statement of holding, as per his/her choice, that is electronically or physical. If there are no transactions in any quarter, no transaction statement may be sent for that quarter.

However, in order to reduce the cost of compliance of DPs, the following rationalization measures have been prescribed for regular accounts:

(a) Accounts with zero balance and nil transactions during the year: The DPs shall send one physical statement of holding annually to such BOs and shall resume sending the transaction statement as and when there is a transaction in the account.

(b) Accounts which become zero balance during the year: For such accounts, no transaction statement may be sent for the duration when the balance remains nil. However, an annual statement of holding shall be sent to the Beneficiary Owner.

(c) Accounts with credit balance: For accounts with credit balance but no transactions during the year, one statement of holding for the year shall be sent to the BO.

8.5 Summary

The legal framework for depository system in the Depositories Act, 1996 provides for the establishment of single or multiple depositories. There are two Depositories functioning in India, namely the National Securities Depository Limited (NSDL) and the Central Depository Services (India) Limited (CDSL). A Depository Participant (DP) is the representative (agent) of the investor in the depository system providing the link between the Company and investor through the Depository. SEBI (Depositories and Participants) Regulations, 1996 regulates the function of Depositories and participants. Both the Depositories in India have allowed Company Secretaries in Whole-time Practice to undertake internal audit of the operations of Depository Participants (DPs).

8.6 Self Assessment Questions

1. Briefly outline the concept of Depository system in India.
2. Enumerate the enquiry, inspection and penalties under the Depositories Act, 1996.
3. Explain in detail the power of depositories to make bye-laws under the Depositories Act, 1996.
4. Give an overview of the rights and obligations of Depositories, Participants and issuers under SEBI (Depositories and Participants) Regulations, 1996.
5. Briefly explain the role and responsibilities of a Qualified Depository Participant.
6. Explain in detail the Statement required to be sent to the beneficial owner by a DP under BSDA facility?
7. Write short note on:
   (a) Dematerialisation charges.
   (b) Models of Depository.
   (c) Internal Audit of Depository Participants.
   (d) Concurrent Audit.

Unit - 9 : Settlement Agencies

Structure of Unit:

9.0 Learning Objectives

After completing this unit, you would be able to:

- Understand the concept of rolling settlement;
- Know about major difference between the rolling settlement and account period settlement;
- Identify the parties involved in the process of clearing and settlement;
- Understand the procedure of settlement of trades;
- Point out the various agencies involved in the process of settlement of trades in stock exchange;
- Learn about the concept, functions, membership rules and norms of eligibility to be followed by the relevant agencies;
- Classify the various types of members working in different settlement agencies in India.

9.1 Introduction

Earlier the investors used to follow account period settlement for settling all the trades in the stock market. Account period is a system that encourages liquidity in the market because people can buy and sell without having to pay immediately ─ almost like using a credit card. But the flip side of the system is that the longer it takes between a trade (a buy or sell) and actual settlement, the riskier the system is. Nowadays, the scenario has totally changed. The clearing and settlement system has become very transparent and therefore, people have also started having faith in the market and its operations, the use of super computer to carry out the trades and to maintain their records has actually made the market operations crystal clear.

9.2 Rolling Settlement

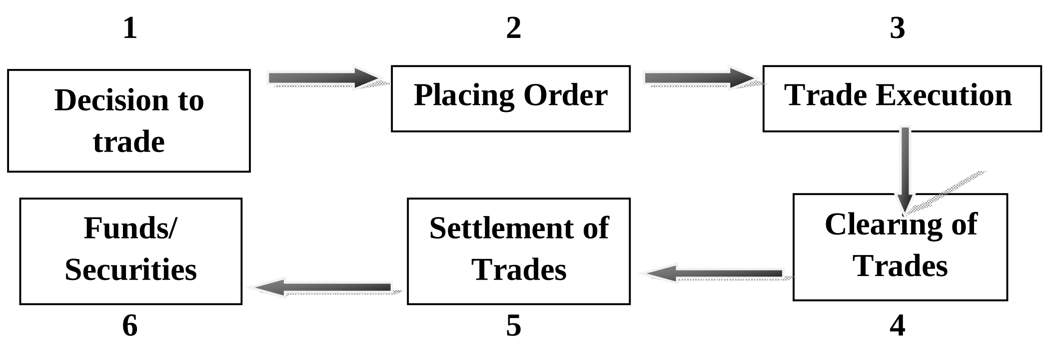
One of the greatest achievements of the current system is settlement of trades within three working days, i.e., T+2 rolling settlement which has replaced account period settlement, which used to take at least a week to define the obligations. Rolling settlement has now been introduced for all securities. Rolling settlement involves shrinking the netting period to one day. This is part of the historical progression that the investors have followed in India’s equity market. The length of the netting period has gone from an undisciplined fortnight to a disciplined week, and with rolling period it now goes to a day.

A transaction cycle depicts the steps followed by a client in order to execute a trade wherein a buy order matches with a sell order.

ACCOUNT PERIOD SETTLEMENT

Wed Thu Fri Sat Sun Mon Tues Wed

T+2 ROLLING SETTLEMENT



9.3 Settlement Agencies

The NSCCL, along with other agencies like clearing members, custodians, clearing banks and depositories settles trades executed on the exchange. The roles of each of the entities are explained below:-

- **National Securities Clearing Corporation Limited (NSCCL)**

The NSCCL, a wholly owned subsidiary of NSE, was incorporated in August 1995. NSCCL commenced clearing operations in April 196. It was set up for the following purposes:

- To bring and sustain confidence in clearing and settlement of securities;
- To promote and maintain, short and consistent settlement cycles;
- To provide counter-party risk guarantee, and
- To operate a tight risk containment system.

NSCCL carries out the clearing and settlement of the trades executed in the Equities and Derivatives segments and operates. It operates a well-defined settlement cycle and there are no deviations or deferments from this cycle. It aggregates trades over a trading period, nets the positions to determine the liabilities of members and ensures movement of funds and securities to meet respective liabilities. NSCCL has empanelled 13 clearing banks to provide banking services to trading members and has established connectivity with both the depositories for electronic settlement of securities. NSCCL has empanelled 13 clearing banks namely Axis Bank Ltd., Bank of India, Canara Bank, Citibank N.A, HDFC Bank, Hongkong & Shanghai Banking Corporation Ltd., ICICI Bank, IDBI Bank, IndusInd Bank, Kotak Mahindra Bank, Standard Chartered Bank, State Bank of India and Union Bank of India.

Functions of NSCCL:

NSCCL carries out clearing and settlement functions as per the settlement cycles provided in the settlement schedule. Clearing is the process of determination of obligations, after which the obligations are discharged by settlement. The clearing function of the clearing corporation is designed to work out:

a) what members are due to deliver and

(b) what members are due to receive on the settlement date.

Settlement is a two way process which involves transfer of funds and securities on the settlement date. NSCCL has also devised mechanism to handle various exceptional situations like security shortages, bad delivery, company objections, auction settlement etc. Every Clearing Member is required to maintain and operate clearing accounts with any of the empanelled clearing banks at the designated clearing bank branches. The clearing accounts are to be used exclusively for clearing & settlement operations. Subsidiary General Ledger (SGL) is created for settlement of trades in government securities. It performs the following tasks:

- Clears all trades;
- Determines obligations of members;
- Arranges for pay-in of funds and securities;
- Arranges for pay-out of funds and securities;
- Assumes the counter-party risk of each member and guarantees financial settlement;
- It also undertakes settlement of transactions on other stock exchanges like, the Over the Counter Exchange of India.

Through NSCCL, the investors have been able to upgrade the clearing and settlement procedures in the Indian Stock Market and have brought Indian financial markets in line with international markets.

Working of NSCCL:

NSCCL has two categories of clearing members: trading clearing members and custodians. Trading members can trade on a proprietary basis or trade for their clients. All proprietary trades become the member's obligation for settlement. Where trading members trade on behalf of their clients they could trade for normal clients or for clients who would be settling through their custodians. Trades which are for settlement by Custodians are indicated with a Custodian Participant (CP) code and the same is subject to confirmation by the respective Custodian. The custodian is required to confirm settlement of these trades on T + 1 day by the cut-off time 1.00 p.m. Non-confirmation by custodian devolves the trade obligation on the member who had input the trade for the respective client.

A multilateral netting procedure is adopted to determine the net settlement obligations (delivery/receipt positions) of the clearing members. Accordingly, a clearing member would have either pay-in or pay-out obligations for funds and securities separately. In the case of securities in the Trade for Trade – Surveillance segment and auction trades, obligations are determined on a gross basis i.e. every trade results into a deliverable and receivable obligation of funds and securities. Members pay-in and pay-out obligations for funds and securities are determined by 2.30 p.m. on T + 1 day and are downloaded to them so that they can settle their obligations on the settlement day (T+2).

Settlement Cycle of NSCCL:

The important settlement types undertaken by NSCCL are as follows:

- Normal segment (N)
- Trade for trade Surveillance (W)
- Retail Debt Market (D)
- Limited Physical market (O)
- Non cleared TT deals (Z)
- Auction normal (A)

Trades in the settlement type N, W, D and A are settled in dematerialized mode. Trades under settlement type O are settled in physical form. Trades under settlement type Z are settled directly between the members and may be settled either in physical or dematerialized mode. Details of the two modes of settlement are as under:

Physical Settlement

Limited physical Market : To provide an exit route for small investors holding physical shares in securities the Exchange has provided a facility for such trading in physical shares not exceeding 500 shares in the 'Limited Physical Market' also known as small window. Delivery of shares in street name and market delivery (clients holding physical shares purchased from the secondary market) is treated as bad delivery.

The shares standing in the name of individuals/HUF only would constitute good delivery. The selling/delivering member must necessarily be the introducing member.

- Any delivery of shares which bears the last transfer date on or after the introduction of the security for trading in the LP market is construed as bad delivery.
- Any delivery in excess of 500 shares is marked as short and such deliveries are compulsorily closed-out.
- Shortages, if any, are compulsorily closed-out at 20% over the actual traded price. Non rectification/replacement for bad delivery are closed out at 10% over the actual trade price. Non rectification/replacement for objection cases are closed out at 20% above the official closing price in regular Market on the auction day.
- The buyer must compulsorily send the securities for transfer and dematerialization, latest within 3 months from the date of pay-out.
- Company objections arising out of such trading and settlement in this market are reported in the same manner as is currently being done for normal market segment. However securities would be accepted as valid company objection, only if the securities are lodged for transfer within 3 months from the date of pay-out.

Dematerialised Settlement

NSCCL follows a T+2 rolling settlement cycle. For all trades executed on the T day, NSCCL determines the cumulative obligations of each member on the T+1 day and electronically transfers the data to Clearing Members (CMs). All trades concluded during a particular trading date are settled on a designated settlement day i.e. T+2 day. In case of short deliveries on the T+2 day in the normal segment, NSCCL conducts a buy –in auction on the T+2 day itself and the settlement for the same is completed on the T+3 day, whereas in case of W segment there is a direct close out. For arriving at the settlement day all intervening holidays, which include bank holidays, NSE holidays, Saturdays and Sundays are excluded. The settlement schedule for all the settlement types in the manner explained above is communicated to the market participants vide circular issued during the previous month.

Table 1: Settlement Cycle

	Activity	**Day**
Trading	Rolling Settlement Trading	T
Clearing	Custodial Confirmation	T+1 working days
	Delivery Generation	T+1 working days
Settlement	Securities and Funds pay in	T+2 working days
	Securities and Funds pay out	T+2 working days
	Valuation Debit	T+2 working days
Post Settlement	Auction	T+2 working days
	Auction settlement	T+3 working days
	Bad Delivery Reporting	T+4 working days
	Rectified bad delivery pay-in and pay-out	T+6 working days
	Re-bad delivery reporting and pickup	T+8 working days
	Close out of re-bad delivery and funds pay-in & pay-out	T+9 working days

Clearing Members

Clearing members are responsible for settling the trades done on all the counters. Settling the trades involves taking the responsibility of making available the resources required on time, i.e. making available the funds and securities on the settlement day. Settlement day would mean T+2 day. Funds are made available through the clearing banks where the clearing member has his account and securities are made available through the depository participant. In case of trades done on the capital market segment, all trading members have to be their own clearing members too i.e. they only have to settle the trades done by them (every Trading Member has to be his own). In case of trades done in 'Future and Option' market, clearing member can be a separate entity than trading member as the volume of trades done in this segment is huge. A clearing member has to get himself registered with NSCCL.

A Clearing Member's open position is arrived by aggregating the open position of all the Trading Members (TM) and all custodial participants clearing through him. A TM's open position in turn includes his proprietary open position and clients' open positions.

- Proprietary / Clients' Open Position: While entering orders on the trading system, TMs are required to identify them as proprietary (if they are own trades) or client (if entered on behalf of clients) through 'Pro / Cli' indicator provided in the order entry screen. The proprietary positions are calculated on net basis (buy - sell) and client positions are calculated on gross of net positions of each client i.e., a buy trade is off-set by a sell trade and a sell trade is off-set by a buy trade.

- Open Position: Open position for the proprietary positions are calculated separately from client position.

Functions of Clearing Members:

A Clearing Member (CM) of NSCCL has the responsibility of clearing and settlement of all deals executed by Trading Members (TM) on NSE, who clear and settle such deals through them. Primarily, the CM performs the following functions:

- Clearing - Computing obligations of all his TM's i.e. determining positions to settle.
- Settlement - Performing actual settlement. Only funds settlement is allowed at present in Index as well as Stock futures and options contracts.
- Risk Management - Setting position limits based on upfront deposits / margins for each TM and monitoring positions on a continuous basis.

Types of Clearing Members:

- Trading Member-Clearing Member (TM-CM): A Clearing Member, who is also a TM, may clear and settle their own proprietary trades, their clients' trades as well as trades of other TM's & Custodial Participants
- Professional Clearing Member (PCM): A CM who is not a TM. Typically banks or custodians could become a PCM and clear and settle for TM's as well as of the Custodial Participants
- Self Clearing Member (SCM): A Clearing Member who is also a TM. Such CMs may clear and settle only their own proprietary trades and their clients' trades but cannot clear and settle trades of other TM's.

Clearing Member Eligibility Norms:

A clearing member has to follow the following eligibility norms imposed by the NSCCL:

- A clearing member should have a net worth of at least Rs.300 lakhs. The net worth requirement for a CM who clears and settles only deals executed by him is Rs. 100 lakhs.
- A clearing member should have a deposit of Rs. 50 lakhs to NSCCL which forms part of the security deposit of the CM
- A clearing member has to do an additional incremental deposit of Rs.10 lakhs to NSCCL for each additional TM in case the CM undertakes to clear and settle deals for other TMs.

Custodians

The custodians perform the task no keeping the securities in a safe manner/custody. They hold the documentary proof of securities, keeping the title of securities intact in the name of the holder. In NSCCL, custodian is only a clearing member and not a trading member. A custodian is required to settle the trades only after confirming to the NSCCL that it will be settling the trade or not. If it takes the obligation, it will have to settle the trades and if not, then the obligation is assigned back to the trading member for whom the custodian works.

Role of Custodians:

The role of a custodian in case of settlement and clearing of trades are:

- Hold in safekeeping assets/securities such as stocks, bonds, commodities such as precious metals and currency (cash), domestic and foreign.
- Arrange settlement of any purchases and sales and deliveries in/out of such securities and currency.
- Collect information on and income from such assets (dividends in the case of stocks/equities and coupons (interest payments) in the case of bonds) and administer related tax withholding documents and foreign tax reclamation.
- Administer voluntary and involuntary corporate actions on securities held such as stock dividends, splits, business combinations (mergers), tender offers, bond calls, etc.
- Provide information on the securities and their issuers such as annual general meetings and related proxies.
- Maintain currency/cash bank accounts, effect deposits and withdrawals and manage other cash transactions.
- Perform foreign exchange transactions.
- Often perform additional services for particular clients such as mutual funds; examples include fund accounting, administration, legal, compliance and tax support services.

- **Clearing Banks**

Clearing banks act as a link between the clearing members and the NSCCL for the settlement of funds, i.e. pay-in and pay-out of funds. Every clearing member gets an account opened with a clearing bank for this purpose only. A clearing bank works on the instructions of the clearing member. A clearing member after defining the obligations in terms of funds informs the clearing bank about the obligations to be fulfilled. The clearing bank makes available the funds required on the pay-out day to meet the obligations on time.

Every Clearing Member is required to maintain and operate clearing accounts with any of the empanelled clearing banks at the designated clearing bank branches. The clearing accounts are to be used exclusively for clearing & settlement operations. NSCCL has empanelled 13 clearing banks namely Axis Bank Ltd., Bank of India, Canara Bank, Citibank N.A, HDFC Bank, Hongkong & Shanghai Banking Corporation Ltd., ICICI Bank, IDBI Bank, IndusInd Bank, Kotak Mahindra Bank, Standard Chartered Bank, State Bank of India and Union Bank of India.

Clearing Account with the Clearing Banks:

- Every Clearing Member is required to maintain and operate a primary clearing account with any one of the empanelled clearing banks at the designated clearing bank branches. The primary clearing account is to be used exclusively for clearing operations i.e., for settling funds and other obligations to the Clearing Corporation including payments of margins and penal charges. A Clearing member having funds obligation to pay shall ensure availability of sufficient clear balance in the clearing account on or before the stipulated funds pay-in day and the stipulated time.
- Further, every clearing member can maintain and operate additional clearing accounts exclusively for the purpose of enhancement of collaterals. All the credits and debits other than collateral enhancement specified by the member shall be routed through the primary clearing account
- Clearing Members are required to authorize the Clearing Bank to access their clearing accounts for debiting and crediting their accounts, reporting of balances and other information as may be required by NSCCL from time to time as per the specified format. The Clearing Bank will debit/ credit the clearing account of clearing members as per instructions received from the Clearing Corporation.
- A Clearing member can deposit funds into this accounts in any form, but can withdraw funds from these accounts only in self-name.
- Clearing members shall not seek to close or de-activate the clearing account without the prior written consent of the Clearing Corporation

Change in Primary Clearing Bank:

In case a clearing member wishes to shift the primary clearing account from one designated clearing bank to another designated clearing bank, the following procedure is required to be followed:

- The clearing member while requesting the Clearing Corporation for a change in the primary clearing bank account shall either:

(i) Furnish the no objection certificate (NOC) received by the member from the existing primary clearing bank for shifting of account, or

(ii) In case no response was received by the clearing member from the existing primary clearing bank in respect of the NOC request even after a minimum waiting period of a fortnight, a declaration to the above effect along with an acknowledged copy of the NOC request made by the member to the existing primary clearing bank.

- The Clearing Corporation would thereon issue a letter of introduction to the other designated clearing bank.
- On opening the account with the other designated clearing bank, the clearing member shall submit to the Clearing Corporation the account particulars issued by the bank and also the acknowledged copy of the letter issued by the clearing member to the clearing bank.
- The Clearing Corporation shall thereon communicate the date from which the new primary clearing account will be operational. The clearing members are required to intimate the Clearing Corporation whether they wish to continue the existing primary clearing account as one of the additional clearing accounts or discontinue the existing primary clearing account after the change in primary clearing bank. In the event where the clearing members wish to discontinue the existing primary clearing account, the Clearing Corporation shall communicate the date after which the existing primary clearing account may be closed by the clearing member.

- **Depositories**

A depository is a firm wherein the securities of an investor are held in electronic form in the same way a bank holds money. It carries out the transactions of securities by means of book entry, without any physical movement of securities. The depository based settlement system is also called 'book entry transfer settlement'. The depository acts as a defecto owner of the securities lodged with it for the limited purpose of transfer of ownership. It functions as a custodian of securities of its clients. The name of the depository appears in the records. With increase in the number of transactions in the stock market, it had become difficult for the investors to hold share certificates and debt instruments in bulk. But now, depository institutions handle this job. At present, there are two depositories in India.

(a)National Securities Depository Ltd.(NSDL)(b)Central Depository Services(India)Ltd.(CDSL)

A clearing member/custodians opens a securities pool account (demat) with a depository participants of these depositories to make the securities available in the account on the settlement day. As per the instructions, the depository transfers the securities electronically.

(a) National Securities Depository Ltd. (NSDL)

NSDL was the first depository organisation promoted by IDBI, UTI and National Stock Exchange (NSE). NSDL was set up to provide electronic depository facilities for securities being traded in capital market. The depositories ordinance was promulgated by the Government of India in September, 1995. The Securities and Exchange Board of India (SEBI) issued the guidelines for depositories in May, 1996. The Bill was passed by the parliament in July 1996, whereas NSDL was registered by SEBI on June 07, 1996.

NSDL, the first and largest depository in India was promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standards that handles most of the securities held and settled in dematerialised form in the Indian capital market.

Although India had a vibrant capital market which is more than a century old, the paper-based settlement of trades caused substantial problems like bad delivery and delayed transfer of title till recently. The enactment of Depositories Act in August 1996 paved the way for establishment of NSDL, the first depository in India. This depository promoted by institutions of national stature responsible for economic development of the country has since established a national infrastructure of international standard that handles most of the trading and settlement in dematerialised form in Indian capital market.

Using innovative and flexible technology systems, NSDL works to support the investors and brokers in the capital market of the country. NSDL aims at ensuring the safety and soundness of Indian marketplaces by developing settlement solutions that increase efficiency, minimise risk and reduce costs. At NSDL, we play a quiet but central role in developing products and services that will continue to nurture the growing needs of the financial services industry.

In the depository system, securities are held in depository accounts, which is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is done through simple account transfers. This method does away with all the risks and hassles normally associated with paperwork. Consequently, the cost of transacting in a depository environment is considerably lower as compared to transacting in certificates.

Basic Services of NSDL:

Under the provisions of the Depositories Act, NSDL provides various services to investors and other participants in the capital market like, clearing members, stock exchanges, banks and issuers of securities. These include basic facilities like account maintenance, dematerialisation, dematerialisation, settlement of trades through market transfers, off market transfers & inter-depository transfers, distribution of non-cash corporate actions and nomination/ transmission.

NSDL carries out its activities through services providers like Depository Participants (DPs), Issuing Companies and their Registrars and Share Transfer Agents, Clearing Corporations/Clearing House of Stock Exchanges. The investors can obtain depository services by opening a demat account with a depository participant of NSDL.

Issuer company can make dematerialization services available to its shareholders by entering into an agreement with NSDL and by establishing an electronic link with NSDL. A Clearing member has to open a clearing account in the depository system for receiving the securities from its clients for delivery to the Clearing House/Clearing Corporations as pay-in and to distribute the pay-out to its clients received from the Clearing Corporation/House. The Clearing Corporations/Houses of stock exchanges are linked electronically to the depository in order to electronically receive securities delivered by clearing members towards pay-in and to give out securities to clearing members towards pay-out. These service providers are also Business Partners in NSDL terminology. NSDL is electronically linked to each of these business partners via a satellite link through Small Aperture Terminals (VSATS) or through Leased landlines. The entire integrated system is called the "NEST" (National Electronic Settlement & Transfer).

Promoters/Shareholders of NSDL:

NSDL is promoted by Industrial Development Bank of India (IDBI) - the largest development bank of India, Unit Trust of India (UTI) - the largest mutual fund in India and National Stock Exchange (NSE) - the largest stock exchange in India. Some of the prominent banks in the country have taken a stake in NSDL.

Safety Measures Taken by NSDL:

In order to ensure safety of the investor holdings, various checks and measures have been taken by NSDL. These include:

1. A DP has to get itself registered with SEBI in order to be operational.
2. DPs are allowed to affect any debit and credit to an account only when a valid instruction is received from the client.
3. NSDL carries out periodic inspection into records and the activities of both DP and R&T agents.
4. Every day, there is a system driven mandatory reconciliation between participant and NSDL.
5. All investors have a right to receive their statement of accounts periodically from the DP.
6. NSDL forwards statement of account to the investors every month at random as a counter check.
7. All grievances of the investors are to be resolved by the concerned business partner. In case, he fails to do so, investor has the right to approach NSDL's investor relationship cell.
8. NSDL has taken up a comprehensive insurance policy to protect the interest of the investors in case of failure of the DP to resolve a genuine loss.
9. An investor can transfer his holdings to an account held with another DP, in case, the DP in which he is holding an account goes bankrupt.

Special Services Offered by NSDL:

In addition to the main services of electronic custody and trade settlement services, NSDL provides special services like pledge, hypothecation of securities, automatic delivery of securities to Clearing Corporations, distribution of cash and non-cash corporate benefits, stock lending, distribution of securities to allotted in case of public issues, internet based services for clearing members, 'SPEED' and Internet based services for demat account holders 'SPEED-e'. SPEEDe is a common infrastructure of

NSDL and any DP of NSDL can subscribe to it. SPEEDe enables demat accountholders (including clearing members) to submit delivery instructions directly on the internet through Speed-e website.

(b) Central Depository Services (India) Ltd. (CDSL)

A Depository facilitates holding of securities in the electronic form and enables securities transactions to be processed by book entry. The Depository Participant (DP), who as an agent of the depository, offers depository services to investors. According to SEBI guidelines, financial institutions, banks, custodians, stockbrokers, etc. are eligible to act as DPs. The investor who is known as beneficial owner (BO) has to open a demat account through any DP for dematerialization of his holdings and transferring securities.

The balances in the investors account recorded and maintained with CDSL can be obtained through the DP. The DP is required to provide the investor, at regular intervals, a statement of account which gives the details of the securities holdings and transactions. The depository system has effectively eliminated paper-based certificates which were prone to be fake, forged, counterfeit resulting in bad deliveries. CDSL offers an efficient and instantaneous transfer of securities. CDSL was promoted by BSE Ltd. jointly with leading banks such as State Bank of India, Bank of India, Bank of Baroda, HDFC Bank, Standard Chartered Bank and Union Bank of India.

CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants. Some of the important milestones of CDSL system are:

- CDSL received the certificate of commencement of business from SEBI in February, 1999.
- Honourable Union Finance Minister, Shri Yashwant Sinha flagged off the operations of CDSL on July 15, 1999.
- Settlement of trades in the demat mode through BOI Shareholding Limited, the clearing house of BSE Ltd., started in July 1999.
- All leading stock exchanges like the National Stock Exchange, Calcutta Stock Exchange, Delhi Stock Exchange, The Stock Exchange, Ahmadabad, etc have established connectivity with CDSL.
- As at the end of Jan 2012, Over 10,000 issuers have admitted their securities (equities, bonds, debentures, commercial papers), units of mutual funds, certificate of deposits etc. into the CDSL system.

Promoters of CDSL:

CDSL was promoted by BSE Ltd. in association with Bank of India, Bank of Baroda, State Bank of India and HDFC Bank. BSE Ltd. has been involved with this venture right from the inception and has contributed overwhelmingly to the fruition of the project. The initial capital of the company is 104.50 crores (INR).

Features of CDSL:

i. **Wide Coverage.** CDSL has over 165 DPs spread around 100 cities/towns across the country. Thus it is convenient for an investor to select a DP as per his requirement.

ii. **On-line DP Services.** DP can provide on-line depository services because CDSL's system is based on centralized database architecture.

iii. **Reasonable Fee.** CDSL has kept the tariff rates at the lowest in order to provide affordable depository services to investors. It does not charge any fees from its depository participants in respect of custody or ISIN (International Securities Identification Number).

iv. **Internet Access.** Demat account holders can have an access to their accounts on internet because DPs are registered with CDSL for internet access.

v. **Contingency Arrangements.** CDSL has made provisions for contingency terminals which help a DP to update transactions in case there is any problem with the system.

vi. **Helpline.** Any DP or an investor can obtain clarifications and guidance from CDSL's prompt and courteous helpline facility.

vii. **Stores Records.** CDSL stores records describing the ownership of securities. This service makes it possible for securities settlement in India to be conducted electronically, instead of requiring the presentation of physical scrip such as share certificates.

viii. **Electronic Settlement.** CDSL facilities electronic settlement of securities. The company connects and performs tens of thousands of transactions every day, linking hundreds of companies to India's stock exchanges.

Depository Participants (DPs) of CDSL:

CDSL's demat services are extended through its agents called ***Depository Participants* (DP)**. The DP is the link between the investor and CDSL. An investor who opens a demat account with a DP can utilize the services offered by CDSL. While the DP processes the instructions of the investor, the account and records thereof is maintained with CDSL. A DP is thus a "Point of Service" for the investor.

CDSL's system is based on centralized database architecture with on-line connectivity with DPs. Because of this centralized architecture, the cost for setting up a DP outfit under CDSL system is significantly lower. Similarly, the recurring costs to be incurred by a CDSL-DP in terms of maintaining back-ups and the related data storage are minimal. This enables a CDSL-DP to offer depository services to investors at an attractive price and at the same time achieve break-even faster at much lower volumes. The centralized architecture also allows CDSL-DP to make available to the investors a to-the-minute status of their account and transactions. CDSL-DPs can also set up branches with direct electronic connectivity with CDSL. CDSL-DPs can also extend service to investors through their various service centers connected through their back office.

Services Offered by CDSL:

The Depository Participant (DP) is the link between the investor, the company and CDSL and provides the following services:

Account Opening: To utilize the services offered by a depository, any person having investment in any security or intending to invest in securities needs to have a demat account with a CDSL-DP. The holder of such demat account is called as **"Beneficial Owner (BO)"**. A BO can maintain a demat account with zero balance in such account. A BO can open more than one account with the same or multiple DPs, in the same name/s and order, if he/she desires so. The investor can approach any DP/s of his/her choice to open a demat account.

Dematerialization: Dematerialization is a process by which physical certificates (of shares/ debentures/other securities) are converted into electronic balances. A BO has to submit the request for dematerialization by submitting the demat request form (DRF) duly completed along with the concerned physical certificates, to his/her DP.

Processing Delivery & Receipt Instructions: To settle trades done on a stock exchange (on-market trades) and trades, which are directly settled between two BOs (off-market trades), BOs submit duly completed delivery instructions in the prescribed form to DP. For receipt of securities into his/her account, a BO can give one time "standing instruction" to DP. Once such a standing instruction is given to the DP, there is no need to submit separate instructions for receipt every time the investor buys securities.

Account Statement: Generally a DP sends to the BO, a statement of his account, monthly, if there is any transaction in the account or every quarter if the account is not operated during that period. The balances and transactions can also be viewed by the BOs through CDSL web based facility '**e***asi*'.

Dematerialization: Dematerialization is the process by which the electronic balances held in the demat account can be converted back into physical certificates.

Pledging: If the BO decides to pledge any securities in his BO account, he can avail of the same by submitting the pledge creation form duly completed, to his DP.

Nomination: Individual BOs have a facility for nomination in favour of an individual. If the sole or all the joint holders are deceased, the shares of different companies held in the demat account will be transmitted easily to the demat account of the nominee on submission of the death certificate and transmission form. It may be noted that in the event of the death of one of the joint holders, the securities will be transmitted in the demat account of the surviving holders.

Transmission of securities: CDSL offers a facility for transmission of balances held in BO account/s (to other BO account/s) if so required due to death, lunacy, bankruptcy, insolvency or required due to operation of any law.

Change in Address: A BO who wishes to register his change in address submits his/her request in writing to his/her DP. The changes entered by the DP in the CDSL system will be automatically downloaded to all the companies in which the BO is holding securities. This facility offered by CDSL saves money, time and effort for the BO.

Bank Account Details: SEBI has made it mandatory for companies to print details of bank account of the BO on dividend/interest warrants etc. to prevent possibilities of misuse of the warrants. All BOs should submit a request in writing to the DP if they wish to record / change their bank account details.

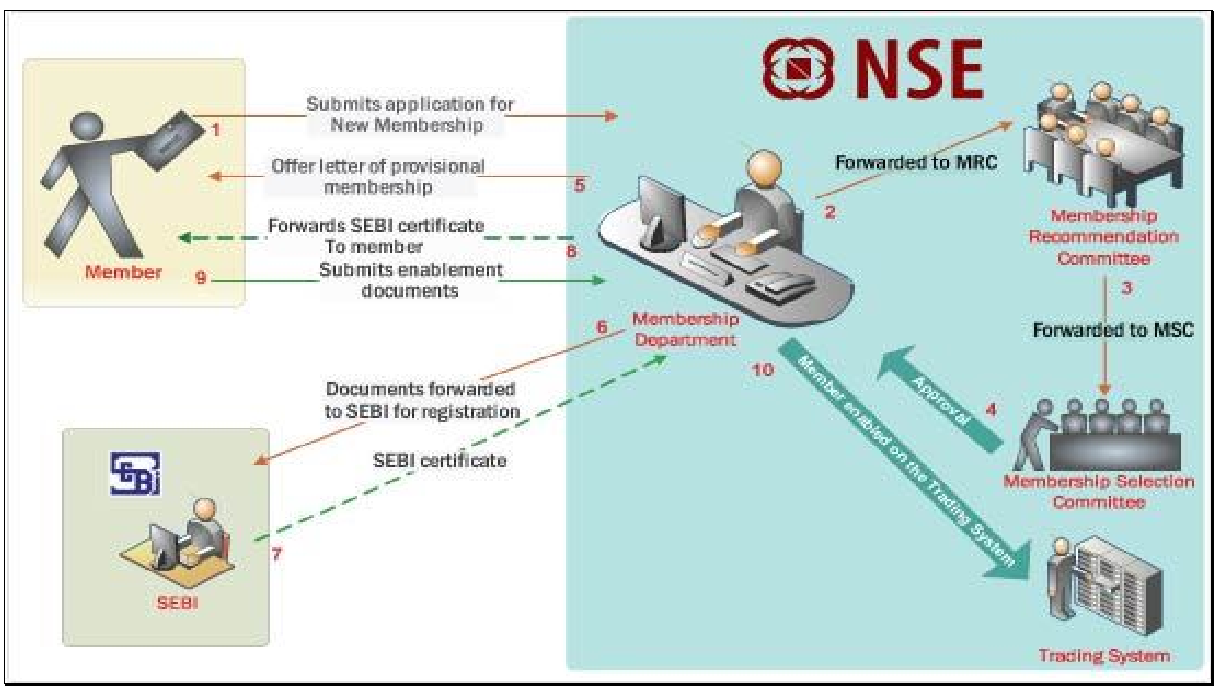
SMS: CDSL sends SMS regarding transactions and modifications in account details to the mobile number registered in the account.

Professional Clearing Members (PCMs)

Professional Clearing Members (PCMs) are special category of members who undertake to clear and settle trades done by the brokers/traders who have appointed them to do the job. They take the responsibility of clearing the trades done by their clients and in no circumstances they perform the task of trading. The clearing banks and the depository act as an interface between the NSCCL and the clearing members/custodians.

Admission Process and Membership:

The following steps are taken by National Stock Exchange (NSE) for admission of any member in the exchange or any other activity related to it. Also the documents required are mentioned below:



Source: www.nseindia.com

Eligibility Norms for PCM:

The following persons are eligible to become PCMs of NSCCL provided they fulfil the prescribed criteria:

- SEBI Registered Custodians; or
- Banks recognised by NSEIL/NSCCL for issuance of bank guarantees

9.4 Summary

After introducing new settlement system and change in the state of art of information technology, many latest innovations have taken place like emergence of clearing corporation to assume counterparty risks, replacement of account period settlement by rolling settlement system leading to shorter settlement cycle, dematerialization of securities has been adopted in place of physical securities; electronic transfer of securities through book entry system and fine tuning of risk management. But still many of these have not been implemented fully as they are yet to reach the masses and penetrate the whole market for the betterment and efficiency of the financial stock market.

9.5 Self Assessment Questions

1. What do you mean by Rolling Settlement? Discuss the major factor of bifurcation between the account period settlement and rolling settlement.
2. Discuss in detail the transaction cycle to execute buying and selling of securities.
3. What are various parties involved in the settlement of trade and their relevant roles involved in the process?
4. What are depositories and how do they function in India? Name the two major depositories working in India and the services offered by them in the settlement of security trade.
5. Write short notes on:
   (a) Clearing Members.
   (b) Professional Clearing Members (PCM)
   (c) Custodians.

9.6 Reference Books

- Francis, J.C., "Investment Analysis and Management', 5th Edition, McGraw Hill International Edition.
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- Khan, M.Y., "Indian Financial System", 5th Edition, Tata-McGraw Hills Publishing Companies Limited, 2007.

Unit : 10 Securities and Exchange Board of India

Structure of Unit

10.0 Learning Objectives

In this Unit the student will be able to know:

- The powers and functions of SEBI
- Provisions relating to regulation of financial intermediaries, penalties for insider trading and fraudulent practices, promoting investors education and training.
- Inspection of various regulated entities.

10.1 Introduction

Securities and Exchange Board of India (SEBI) has been established with twin objective of protecting the interest of investors and to promote the development of and to regulate the Securities Market. Since its establishment in 1992 lot of initiatives have been taken to protect the interests of Indian investors.

Before 1992, the three principal Acts governing the securities markets were: (a) the Capital Issues (Control) Act, 1947, which restricted issuer's access to the securities market and controlled the pricing of issues; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; and (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges. The Capital Issues (Control) Act, 1947 had its origin during the war in 1943 when the objective was to channel resources to support the war effort. The Act was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channeled into proper lines, i.e., for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government, which also determined the amount, type and price of the issue.

Major part of the liberalisation process was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this, Government's control over issue of capital, pricing of the issues, fixing of premia and rates of interest on debentures etc. ceased. The office which administered the Act was abolished and the market was allowed to allocate resources to competing uses. However to ensure effective regulation of the market, SEBI Act, 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI can specify the matters to be disclosed and the standards of disclosure required for the protection of investors in respect of issues; can issue directions to all intermediaries and other persons associated with the securities market in the interest of investors or of orderly development for securities market; and can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. In short, it has been given necessary autonomy and authority to regulate and develop an orderly securities market.

10.2 Objectives of SEBI

- To protect the interests of investors in securities
- To promote the development of, and
- To regulate, the securities market and for matters connected therewith or incidental thereto.

10.3. SEBI ACT, 1992

Chapter I of the Act covers the definitions of various terms under the Act, while Chapter II deals with establishment of SEBI and its management. In terms of section 3 of the Act, SEBI is a body corporate having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable and to contract, sue and be sued in its own name. SEBI has its Head Office at Mumbai and has powers to establish its offices at other places in India. SEBI presently has offices also in Ahmadabad, Jaipur, Kolkata, Guwahati, Bhubaneswar, New Delhi, Chennai and Bengaluru.

Composition of SEBI

Section 4(1) of SEBI Act provides that the SEBI Board shall consist of the following members, namely:

(a) One Chairman;

(b) Two members from amongst the officials of the Ministry of the Central Government dealing with Finance and administration of the Companies Act, 1956;

(c) One member from amongst the officials of the Reserve Bank;

(d) Five other members of whom at least three shall be the whole time members, to be appointed by the Central Government.

The Chairman and the other members are from amongst the persons of ability, integrity and standing who have shown capacity in dealing with problems relating to securities market or have special knowledge or experience of law, finance, economics, accountancy, administration or in any other discipline which, in the opinion of the Central Government, shall be useful to SEBI. The terms and conditions of service of Chairman and members are determined in the rules framed by Government in this regard. The general superintendence, direction and management of the affairs of SEBI vests in a Board of members, which exercises all powers and do all acts and things which may be exercised or done by SEBI. Unless determined otherwise through regulations, the Chairman shall also have all these powers.

10.4. Powers and Functions of SEBI

Chapter IV of SEBI Act, 1992 deals with the powers and functions of the Board.

Section 11 of the Act lays down that it shall be the duty of SEBI to protect the interests of the investors in securities and to promote the development of, and to regulate the securities markets by such measures as it thinks fit. These measures would include:

(a) regulating the business in stock exchanges and any other securities markets;

(b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

(c) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as SEBI may, by notification, specify in this behalf;

(d) registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds;

(e) promoting and regulating self-regulatory organisations;

(f) prohibiting fraudulent and unfair trade practices relating to securities markets;

(g) promoting investors' education and training of intermediaries of securities markets;

(h) prohibiting insider trading in securities;

(i) regulating substantial acquisition of shares and takeover of companies;

(j) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market;

(k) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which is under investigation or inquiry by SEBI;

(l) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956, as may be delegated to it by the Central Government;

(m) levying fees or other charges for carrying out the purposes of this section;

(n) conducting research for the above purposes;

(o) calling from or furnishing to any such agencies, as may be specified by SEBI, such information as may be considered necessary by it for the efficient discharge of its functions;

(p) performing such other functions as may be prescribed.

- SEBI may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in section 12) which intends to get its securities listed on any recognised stock exchange where SEBI has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.
- For carrying out the duties assigned to it under the Act, SEBI has been vested with the same powers as are available to a Civil Court under the Code of Civil Procedure, 1908 for trying a suit in respect of the following matters:

(i) the discovery and production of books of account and other documents at the place and time indicated by SEBI.

(ii) summoning and enforcing the attendance of persons and examining them on oath.

(iii) inspection of any books, registers and other documents of any person listed in section 12 of the Act, namely stock brokers, sub brokers, share transfer agents, bankers to an issue, trustee of trust deed, registrar to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and other such intermediaries associated with securities markets.

(iv) inspection of any book or register or other document or record of any listed company or a public company which intends to get its securities listed on any recognized stock exchange.

(v) issuing commissions for the examination of witnesses or documents.

- As per Section 11(4) SEBI, may, by an order or for reasons to be recorded in writing take any of the following measures either pending investigation or inquiry or on completion of such investigation or enquiry:

(a) suspend the trading of any security in a recognised stock exchange.

(b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities.

(c) suspend any office-bearer of any stock exchange or self regulatory organisation from holding such position.

(d) impound and retain the proceeds or securities in respect of any transaction which is under investigation.

(e) attach for a period not exceeding one month, with prior approval of a magistrate, one or more bank accounts of any intermediary or any person associated with the securities market in any of the Act or rules or regulations made thereunder.

(f) direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation.

10.4.1 Powers

- **To Regulate or Prohibit Issue of Prospectus, Offer Document or Advertisement Soliciting Money for Issue of Securities.**

  Section 11A of SEBI Act provides that SEBI may prohibit for the protection of the investors, any company from Lesson 14 Securities and Exchange Board of India 305 issuing any offer document including a prospectus or advertisement soliciting money from the public for the issue of securities, and specify the conditions subject to which such offer documents can be issued. The Board may specify the matters relating to issue of capital, transfer of securities and other matters shall be disclosed by the companies. It may also by issuing prospectus, any offer document or advertisement soliciting money from public for issue of securities. SEBI may also specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

- **Power to issue Directions**

  Section 11B of the Act provides that if SEBI is satisfied after making due enquiries, that it is necessary:

(i) in the interest of investors, or orderly development of securities market; or

(ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interests of investors or securities market; or

(iii) to secure the proper management of any such intermediary or person,SEBI may issue such directions, -(a) to any person or class of persons referred to in section 12, or associated with the securities market; or

(b) to any company in respect of matters relating to issue of capital, transfer of securities and other matter incidental thereto, as may be appropriate in the interests of investors in securities and the securities market.

10.5. Investigation Procedure

Section 11C of the Act provides that where SEBI has reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board thereunder. It may, at any time by order in writing, direct any person specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to SEBI.

It is the duty of every manager, managing director, officer and other employee of the company and every intermediary or every person associated with the securities market to preserve and to produce to the Investigating Authority or any person authorised by it in this behalf, all the books, registers, other documents and record of, or relating to, the company or, as the case may be, of or relating to, the intermediary or such person, which are in their custody or power.

The Investigating Authority may require any intermediary or any person associated with securities market in any manner to furnish such information to, or produce such books, or registers, or other documents, or record before it or any person authorized by it in this behalf as it may consider necessary if the furnishing of such information or the production of such books, or registers, or other documents, or record is relevant or necessary for the purposes of its investigation. The Investigating Authority may keep in its custody any books, registers, other documents and record produced for six months and thereafter shall return the same to any intermediary or any person associated with securities market by whom or on whose behalf the books, registers, other documents and record are produced. The Investigating Authority may call for any book, or register, other document and record if they are needed again.

If the person on whose behalf the books, registers, other documents and record are produced requires certified copies of the books, registers, other documents and record produced before the Investigating Authority, it shall give certified copies of such books, registers, other documents and record to such person or on whose behalf the books, registers, other documents and record were produced.

Any person, directed to make an investigation may, examine on oath, any manager, managing director, officer and other employee of any intermediary or any person associated with securities market in any manner, in relation to the affairs of his business and may administer an oath accordingly and for that purpose may require any of those persons to appear before it personally.

If any person fails without reasonable cause or refuses to produce to the Investigating Authority or any person authorised by it in this behalf any book, register, other document and record which is his duty to produce; or to furnish any information which it is his duty to furnish; or to appear before the Investigating Authority personally when required to do so or to answer any question which is put to him by the Investigating Authority; or to sign the notes of any examination referred in sub-section (7), he shall be punishable with imprisonment for a term which may extend to one year, or with fine, which may extend to one crore rupees, or with both, and also with a further fine which may extend to five lakh rupees for every day after the first during which the failure or refusal continues.

Notes of any examination under sub-section (5) shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.Where in the course of investigation, the Investigating Authority has reasonable ground to believe that the books, registers, other documents and record of, or relating to, any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an application to the Judicial Magistrate of the first class having jurisdiction for an order for the seizure of such books, registers, other documents and record. After considering the application and hearing the Investigating Authority, if necessary, the Magistrate may, by order, authorize the Investigating Authority to enter, with such assistance, as may be required, the place or places where such books, registers, other documents and record are kept; to search that place or those places in the manner specified in the order; and to seize books, registers, other documents and record it considers necessary for the purposes of the investigation.

It is provided that the Magistrate shall not authorize seizure of books, registers, other documents and record, of any listed public company or a public company which intends to get its securities listed on any recognised stock exchange unless such company indulges in insider trading or market manipulation.The Investigating Authority shall keep in its custody the books, registers, other documents and record seized under this section for such period not later than the conclusion of the investigation as it considers necessary and thereafter shall return the same to the company or the other body corporate, or, as the case may be, to the managing director or the manager or any other person, from whose custody or power they were seized and inform the Magistrate of such return. The Investigating Authority may, before returning such books, registers, other documents and record as aforesaid, place identification marks on them or any part thereof. Every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures made under that Code.

- **Cease and Desist Proceedings**

If the Board finds, after causing an inquiry to be made, that any person has violated, or is likely to violate any provisions of this Act, or any rules or regulations made thereunder, it may pass an order requiring such person to cease and desist from committing or causing such violation. SEBI shall not pass such order in respect of any listed public company or a public company which intends to get its securities listed on any recognized stock exchange unless SEBI has reasonable grounds to believe that such company has indulged in insider trading or market manipulation.

- **Consent Orders**

SEBI has brought the concept of consent order/compounding of offence into force for resolving the disputes in more smooth manner through negotiations and discussions instead of lengthy litigation. SEBI vide its Circular No. EFD/ED/Cir-1/2007 dated 20th April 2007 has issued Guidelines for (i) Consent Orders and (ii) For considering requests for composition of offences, under SEBI Act, SC(R) Act and Depositories Act.

Consent Order means an order settling administrative or civil proceedings between the regulator and a person (Party) who may prima facie be found to have violated securities laws. Here, Administrative/Civil enforcement actions include issuing directions, suspension or cancellation of certificate of registration, imposition of monetary penalty, pursuing suits and appeals in Courts and Securities Appellate Tribunal (SAT). It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

Compounding of offence can take place after filing criminal complaint by SEBI. Compounding is a process whereby an accused pays compounding charges in lieu of undergoing consequences of prosecution. Prosecution includes Filing of criminal complaints before various criminal courts by SEBI for violation of provisions of securities laws which may lead to imprisonment and/ or fine. Compounding of offence allows the accused to avoid a lengthy process of criminal prosecution, which would save cost, time, mental agony, etc in return for payment of compounding.

- **Registration of Intermediaries**

Chapter V of the Act provides for registration of various intermediaries such as stock broker, sub-broker, share transfer agents etc. Section 12(1) of the Act provides that no stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under this Act.

A person buying or selling securities or otherwise dealing with the securities market as a stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market immediately before the establishment of SEBI for which no registration certificate was necessary prior to such establishment, may continue to do so for a period of three months from such establishment or, if he has made an application for such registration within the said period of three months, till the disposal of such

application. Also no depository, participant, custodian of securities, foreign institutional investor, credit rating agency or any other intermediary associated with the securities market as SEBI may by notification in this behalf specify, shall buy or sell or deal in securities except under and in accordance with the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under this Act.

No person shall sponsor or cause to be sponsored or carry on or cause to be carried on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from SEBI in accordance with the regulations. Every application for registration would in such manner and on payment of such fees as may be determined by regulations. The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations. However no such order shall be made unless the person concerned has been given a reasonable opportunity of being heard.

- **Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control.**

Chapter VA of the Act deals with prohibition of manipulative and deceptive devices, insider trading and substantial acquisiton of securities or control. Section 12A of the Act provides that no person shall directly or indirectly:

(a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognized stock exchange;

(c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognized stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(d) engage in insider trading;

(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognized stock exchange incontravention of the regulations made under this Act.

Finance, Accounts and Audit of SEBI

Chapter VI of the Act provides for Finance, Accounts and Audit of SEBI.

Fund

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to SEBI grants of such sums of money as the Central Government may think fit for being utilised for the purposes of this Act. There shall be constituted a fund to be called the Securities and Exchange Board of India General Fund and there shall be credited thereto all grants, fees and charges received by SEBI under this Act; all sums received by SEBI from such other sources as may be decided upon by the Central Government. The Fund shall be applied for meeting the salaries, allowances and other remuneration of members, officers and other employees of SEBI, the expenses of SEBI in the discharge of its functions and the expenses on objects and for purposes authorized by this Act.

Accounts and Audit

SEBI shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor General of India. The accounts of SEBI shall be audited by the Comptroller and Auditor General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by SEBI to the Comptroller and Auditor General of India. The Comptroller and Auditor General of India and any other person appointed by him in connection with the audit of the accounts of the Board shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor General generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of SEBI. The accounts of SEBI as certified by the Comptroller and Auditor General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

10.6. Penalties

Chapter VIA of SEBI Act deals with penalties which can be imposed under the Act for various failures, defaults, non-disclosure and other offences. It may be recalled that Section 11(2)(i) empowers SEBI to call for information and conduct enquiries and audits of the stock exchanges, mutual funds, other persons associated with securities markets, intermediaries and self regulatory organisations in the security market. Also Section 11(ia) of the Act requires calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any central, state or provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board.

Penalty for failure to furnish information, return, etc.

Section 15A lays down that if any person who is required under SEBI Act or any rules or regulations made thereunder:

(a) to furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

(b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

(c) to maintain books of accounts or records, fails to maintain the same, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

Penalty for failure by any person to enter into agreement with clients Section 15B lays down that if any person who is registered as an Intermediary and is required under this Act or any rules or regulations made thereunder, to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to pay a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

- **Penalty for failure to redress investors' grievances.**

Section 15C lays down that if any listed company or any person who is registered as an Intermediary, after having been called upon by SEBI in writing to redress the grievances of Investor, fails to redress such grievances within the time specified by SEBI, such company or intermediary shall be liable to pay a penalty of one lakh rupees for each day during which such failure continues or one crore rupees whichever is less.

- **Penalties for Default**

Section 15D and 15F provide for penalties for default. Penalty for certain defaults in case of mutual funds Section 15D lays down that in case of mutual funds, if any person who is:

(a) required under this Act or any rules or regulations made thereunder to obtain a certificate of registration from SEBI for sponsoring or carrying on any collective investment scheme, including mutual funds, sponsors or carries on any collective investment scheme, including mutual funds, without obtaining such certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme, including mutual funds, or one crore rupees, whichever is less;

(b) registered with SEBI as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

(c) registered with SEBI as a collective investment scheme, including mutual funds, fails to make an application for listing of its schemes as provided for in the regulations governing such listing, he shall be liable to penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

(d) registered as a collective investment scheme, including mutual funds, fails to dispatch unit certificates of any scheme in the manner provided in the regulation governing such despatch, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

(e) registered as a collective investment scheme, including mutual funds, fails to refund the application monies paid by the investors within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

(f) registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, heshall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalty for failure to observe rules and regulations by an asset management company Section 15E lays down that where any asset management company of a mutual fund registered under SEBI Act fails to comply with any of the regulation providing for restrictions on the activities of such company, it shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

Penalties for default in case of stock brokers Section 15F provides if any person registered as a stock broker under SEBI Act –

(a) fails to issue contract notes in the form and in the manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty not exceeding five times the amount for which the contract note was required to be issued by that broker;

(b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less;

(c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty of one lakh rupees or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

- **Penalty for Insider Trading**

Section 15G lays down that if any insider:

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information, he shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

- **Penalty for Non-Disclosure of Acquisition of Shares and Takeovers**

Section 15H lays down that if any person fails to:

(i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or

(ii) make such a public announcement to acquire shares at a minimum price, he shall be liable to a penalty not exceeding five lakh rupees;

(iii) make a public offer by sending letter of offer to the shareholders who sold their shares pursuant to letter of offer, he shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of insider trading;

whichever is higher. Section 15H provides that if a person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of twenty five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

- **Penalty for fraudulent and unfair trade practices**

Section 15HA provides that If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

- **Penalty for contravention**

Section 15HB Whoever fails to comply with any provision of this Act, the rules or regulations made or directions issued by SEBI thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

10.6.1 Adjudications

Section 15-I & J deal with SEBI's power to adjudicate and factors to be taken into account by the adjudicating officer.

(1) For the purpose of adjudging the penalties for failure SEBI appoints any of its officers not below the rank of Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.

(2) While holding an inquiry, the adjudicating officer has powers to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions, he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections. Factors to be taken into account by the adjudicating officer Section 15J lays down that while adjudging the amount of penalty, the adjudicating officer shall have due regard to the following factors viz.,

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default. penalties to be credited to Consolidated Fund of India Section 15JA provides that all sums realised by way of penalties under this Act shall be credited to the consolidated fund of India.

10.7. Securities Appellate Tribunal (SAT)

In order to afford proper appellate remedies, Chapter VIB of SEBI Act provides for the establishment of the Securities Appellate Tribunals to consider appeals against SEBI's orders, of penalties. As per Section 15K, the Central Government is empowered to establish by notifications one or more Appellate Tribunals, to be known as the Securities Appellate Tribunals to exercise the jurisdiction, power and authorities conferred on such Tribunal by SEBI Act or under the Act or any other law for the time being in force. The Central Government has set up a tribunal at Mumbai.

- **Composition of SAT**

According to Section 15L, which deals with the composition of the Tribunal, the Securities Appellate Tribunals shall consist of a Presiding Officer and two other members to be appointed by the Central Government by notification.

- **Qualification for Appointment as Presiding Officer or Member**

Section 15M prescribes that a person shall not be qualified for appointment as the Presiding Officer of Securities Appellate Tribunals unless he is a sitting or retired Judge of the Supreme Court or a sitting or retired Chief Justice of a High Court. It has also been prescribed that the presiding officer of the Securities Appellate Tribunal shall be appointed by the Central Government in consultation with chief justice of India or his nominee. A person shall not be qualified for appointment as a member of Securities Appellate Tribunal unless he is a person of ability, integrity and standing who has shown capacity in dealing with problems relating to securities market and has qualification and experience of corporate law, securities laws, finance, economics or accountancy.

A member of SEBI or any person holding a post at senior management level at SEBI cannot be appointed as presiding officer or member of Securities Appellate Tribunal during his service or tenure as such with SEBI or within two years from the date on which he ceases to hold office as such in SEBI.

- **Resignation and Removal**

The presiding officer or any other member may resign his office, by notice in writing under his hand addressed to the Central Government. The presiding officer or the member would continue to hold office until:

(a) the expiry of three months from the date of receipt of such notice, or

(b) a person duly appointed as his successor enters upon his office, or

(c) the expiry of his term of office, whichever is earliest, unless the Central Government has permitted him to relinquish his office sooner. The Presiding Officer or a member of a Securities Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by a Judge of the Supreme Court, in which the Presiding Officer or member of Securities AppellateTribunal concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of these charges. The Central Government by rules regulates the procedure for the investigation of misbehaviour or incapacity of the presiding officer or the member.

- **Orders Constituting Appellate Tribunal to be Final and not to Invalidate its Proceedings**

Section 15R makes it clear that no order of the Central Government appointing any person as the Presiding Officer of a Securities Appellate Tribunal shall be called in question in any manner, and no Act or proceeding before a Securities Appellate Tribunals shall be called in question in any manner on the ground merely of any defect in the constitution of a Securities Appellate Tribunal.

- **Requirements for Appeal to the Tribunal**

Section 15T and 15U deal with the appeal procedure and power of Securities Appellate Tribunals. Section 15T lays down that any person aggrieved:

(1) (a) by an order of SEBI made, under this Act, or the rules or regulations made thereunder; or

(b) by an order made by an adjudicating officer under this Act may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.

(2) No appeal shall lie to the Securities Appellate Tribunals from an order made (a) by SEBI;

(b) by an adjudicating officer, with the consent of the parties.

(3) Every appeal shall be filed within a period of 45 days from the date on which a copy of the order made by SEBI or the Adjudicating Officer is received by him and it shall be in such form and be accompanied by prescribed fee. However, the Securities Appellate Tribunal may entertain an appeal after the expiry of the said period of 45 days if it is satisfied that there was sufficient cause for not filing it within that period.

(4) On receipt of an appeal, the Securities Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

(5) The Securities Appellate Tribunal shall send a copy of every order made by it to SEBI and the parties to the appeal and to the concerned Adjudicating Officer.

(6) The appeal filed before the Securities Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal.

- **Powers of SAT**

The Securities Appellate Tribunals shall have, for the purposes of discharging their functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect f the following matters, namely:

(a) summoning and enforcing the attendance of any person and examining him on oath;

(b) requiring the discovery and production of documents;

(c) receiving evidence on affidavits;

(d) issuing commissions for the examination of witnesses or documents;

(e) reviewing its decisions;

(f) dismissing an application for default or deciding it ex-parte;

(g) setting aside any order of dismissal of any application for default or any order passed by it ex-parte;

(h) any other matter which may be prescribed.

Every proceeding before the Securities Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code and the Securities Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

Legal representation Section 15V permits the Appellant either to appear in person or authorise one or more of Practising Company Secretaries, Chartered Accountants, Cost Accountants or Legal practitioners or any of its officers to present his or its case before the Securities Appellate Tribunal.

- **Limitation**

As per the section 15W, the provisions of the Limitations Act, 1963 shall apply to an appeal made to Securities Appellate Tribunal.

Public Servants

As per section 15X, the Presiding Officer and other officers and employees of Securities Appellate Tribunal shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code.

- **Jurisdiction of Civil Court**

Section 15Y lays down that no civil court has jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Officer appointed under this Act or a Securities Appellate Tribunal under this Act is empowered by or under this Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

10.8. Appeal to Supreme Court

Section 15Z lays down that any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on any question of fact or law arising out of such order; It has been provided that the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

What is the time period for filling an appeal with SAT and Supreme Court?

• In case of filing appeal with SAT: Within 45 days from the date of order of the copy made by SEBI or adjudicating officer.

• In case of filing appeal with Supreme Court: Within 60 days from the date of communication of the decision or order of SAT.

10.9. Powers of Central Government

(a) To issue directions Section 16 empowers Central Government to issue directions in writing to SEBI on questions of policy as it may deem fit from time to time. However the Central Government shall as far as practicable, give an opportunity to SEBI to express its views before any such directions is given by the Central Government. The decision of the Central Government as to whether a question is one of policy or not shall be final.

(b) To Supercede the Board Section 17 lays down that if at any time the Central Government is of opinion that:

(a) on account of grave emergency, SEBI is unable to discharge the functions and duties imposed on it by or under the provisions of this Act; or

(b) SEBI has persistently made default in complying with any direction issued by the Central Government under this Act or in the discharge of the functions and duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of SEBI or the administration of SEBI has deteriorated; or

(c) circumstances exist which render it necessary in the public interest so to do,

it may, by notification, supersede SEBI for such period, not exceeding six months, as may be specified in the notification.

Upon the publication of the notification, it will have the following effects:

(a) all the members shall, as from the date of supersession, vacate their offices as such;

(b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of SEBI, shall until SEBI is reconstituted under sub-section (3), be exercised and discharged by such person or persons as the Central Government may direct; and (c) all property owned or controlled by SEBI shall, until the Board is reconstituted, vest in the Central Government.

On the expiration of the period of supersession specified in the notification, the Central Government may reconstitute the Board by a fresh appointment and in such case any person or persons who vacated their offices because of supersession shall not be deemed disqualified for appointment.

- **Returns and Reports**

As per Section 18, SEBI is required to furnish to the Central Government at such time and in such form and manner as may be prescribed or as the Central Government may direct, such returns and statements and such particulars in regard to any proposed or existing programme for the promotion and development of the securities market, as the Central Government may from time to time require. SEBI shall within ninety days after the end of each financial year submit to the Central Government a report in such form, as may be prescribed, giving a true and full account of its activities, policy and programmes during the previous financial year and a copy of the report, as soon as may be after it is received, shall be laid down before each House of Parliament.

- **Delegation of Powers**

In accordance with Section 19 of SEBI Act, SEBI may, by general or special order in writing delegate to any member, officer of the Board or any other person subject to such conditions, if any as may be specified in the order, such of its powers and functions under the Act as it may deem necessary.

- **Appeal to the Central Government**

Section 20 of the Act provides that any person aggrieved by an order of SEBI made under this Act or the rules or regulations made thereunder, may prefer an appeal to the Central Government within such time as may be prescribed. The appeal shall not be admitted if it is preferred after the expiry of the period prescribed therefor. However if the appellant satisfies the Central Government that he had sufficient cause for not preferring the appeal within the prescribed period. Every appeal made under this section shall be made in prescribed form and shall be accompanied by a copy of the order appealed against by such fees as may be prescribed.

The procedure for disposing of an appeal shall be such as may be prescribed and the appellant shall be given a reasonable opportunity of being heard.

- **Bar of Jurisdiction**

Section 20A lays down that no order passed by SEBI or the adjudicating officer under this Act shall be appealable except as provided in section 15T or section 20 and no civil court shall have jurisdiction in respect of any matter which the Board (or the adjudicating officer) is empowered by, or under, this Act to pass any order and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any order passed by SEBI or the adjudicating officer by, or under, SEBI Act.

- **Public Servants**

Section 22 of the Act provides that all members, officers and other employees of SEBI while acting or purporting to act in pursuance of any of the provisions of the Act shall be deemed to be public servants within the meaning of Section 21 of the Indian Penal Code. Section 23 provides that no suit, prosecution or other legal proceedings shall lie against the Central Government or SEBI or any officer of the Central Government or any member, officer or other employee of SEBI for anything which is in good faith done or intended to be done under this Act or the rules or regulations made thereunder.

10.10. Offences and Punishments

Section 24 lays down that:

(1) Without prejudice to any award of penalty by the Adjudicating Officer under SEBI Act, if any person contravenes or attempts to contravene or abets the contravention of the provisions of this Act or of any rules or regulations made thereunder, he shall be punishable with imprisonment for a term which may extend to ten years or with fine which may extend to twenty five crore rupees or with both.

(2) If any person fails to pay the penalty imposed by the Adjudicating Officer or fails to comply with any of his directions or orders, he shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to ten years or with fine which may extend to twenty-five crore rupees or with both.

- **Composition of Certain Offences**

Section 24A provides any offence punishable under this Act, not being an offence punishable with imprisonment only or with imprisonment and also with fine, may before or after the institutions of any proceeding, be compounded by a Securities Appellate Tribunal or a Court before which such proceedings are pending.

- **Power to grant Immunity**

As per Section 24B of the Act, the Central Government may on the recommendations by SEBI, if satisfied that any person who is alleged to have violated any of the provisions of this Act or the rules or regulations made thereunder has made a full and true disclosures in respect of alleged violations, grant to such persons, subject to conditions as it may think fit, immunity from prosecution for any offence under this Act with respect to the alleged violation. However no such immunity shall be granted by the Central Government in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of application for grant of such immunity. It has also been provided that recommendations of SEBI shall not be binding upon the Central Government. However, an immunity granted to a person can be withdrawn by the Central Government, if it is satisfied such person had, in the course of the proceedings not complied with the condition on which the immunity was granted or had given false evidence. Such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the contravention. He shall also become liable to the imposition of any penalty under this Act to which such person would have been liable had not such immunity been granted.

- **Cognizance of Offences by Courts**

Section 26 lays down that:

(1) No court shall take cognizance of any offence punishable under this Act or any rules or regulations made thereunder, save on a complaint made by SEBI.

(2) No court inferior to that of a Court of Session shall try any offence punishable under this Act.

Offences by Companies Section 27 on offences by company lays down that:

(1) Where an offence under this Act has been committed by a company, every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly; Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

(2) Notwithstanding anything contained in above, where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. Here 'Company' means anybody corporate and includes a firm or other association of individuals; and 'director', in relation to a firm, means a partner in the firm.

- **Power to make Rules**

Section 29 empowers the Central Government to make rules for carrying out the purposes of this Act. Such rules may provide for all or any of the following matters, namely:

(a) the term of office and other conditions of service of the Chairman and the members of SEBI;

(b) the additional functions that may be performed by SEBI under section 11 of the Act;

(c) the manner in which the accounts of SEBI shall be maintained under section 15;

(d) the manner of inquiry by adjudicating officer;

(e) the salaries and allowances and other terms and conditions of service of the Presiding Officers, members and other officers and employees of the Securities Appellate Tribunal;

(f) the procedure for the investigation of misbehaviour or incapacity of the Presiding Officers or other members of the Securities Appellate Tribunal;

(g) the form in which an appeal may be filed before the Securities Appellate Tribunal and the fees payable in respect of such appeal;

(h) the form and the manner in which returns and report to be made to the Central Government under section 18;

(i) any other matter which is to be, or may be, prescribed, or in respect of which provision is to be, or may be, made by rules.

- **Power to make Regulations**

Section 30 empowers SEBI by notification to make regulations consistent with this Act and the rules made thereunder to carry out the purposes of this Act. Such regulations may provide for all or any of the following matters, namely:

(a) the times and places of meetings of SEBI and the procedure to be followed at such meetings including quorum necessary for the transaction of business;

(b) the terms and other conditions of service of officers and employees of SEBI;

(c) the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies under section 11A.

(d) the conditions subject to which certificate of registration is to be issued, the amount of fee to be paid for certificate of registration and the manner of suspension or cancellation of certificate of registration.

- **Rules, Regulations to be laid before the Parliament**

Section 31 lays down that every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rules or regulation. Section 32 lays down that the provisions of this Act shall be in addition to, and not in derogation of, the provisions of any other law for the time being in force.

10.11 SEBI's (Annual Report) Rules, 1994

The Central Government notified SEBI (Annual Report) Rules 1994, on 7th April, 1994 in exercise of its powers under section 18(2) read with section 29 of SEBI Act, 1992. Rule 3 lays down that SEBI shall submit to the Central Government an annual report giving a true and full account of its activities, policies and programmes during the previous financial year in the prescribed form appended to these rules. Such annual report shall be submitted to the Central Government within 90 days after the end of each financial year. Section 18(3) of SEBI Act lays down that a copy of the annual report submitted by SEBI to Central Government shall be laid before each House of Parliament, as soon as may be after it is received by Central Government.

The form of the annual report is divided into four parts. Part I deals with policies and programmes to be reviewed in respect of the general, economic, environmental and the investment climate, primary and secondary markets, mutual funds, intermediaries, foreign institutional investment, other activities and programmes having a bearing on the working of the Securities Market and finally an assessment and prospects of the times ahead. Part II deals with a review of the working and operation of SEBI in respect of different segments of the market as

detailed under part I. Part III contains details of the functions of SEBI under 13 sub-headings, namely:

(a) Regulation of business in Stock Exchanges including trading and settlement practices;

(b) Registration and regulation of various intermediaries in the securities market including suspension, cancellation of registrations etc.

(c) Registration and regulation of working of collective investment schemes and mutual funds including suspension and cancellation of registrations etc.

(d) Promotion and regulation of self regulatory organisations (SROs);

(e) Fraudulent and unfair trade practices and steps taken by SEBI to prevent recurrences;

(f) Investors education and training of intermediaries;

(g) Prohibition of insider trading and steps initiated to curb such practices;

(h) Substantial acquisition of shares and takeovers;

(i) Information obtained, inspection undertaken, inquiries conducted and results of audits of stock exchanges, intermediaries and SROs by SEBI;

(j) Delegated powers and functions under the SCR Act, 1956;

(k) Fees and other charges collected by SEBI;

(l) Research and studies conducted by SEBI;

(m) Other functions carried out by SEBI on Securities Market.

Part IV of the annual report contains detail of the organisational matter of SEBI.

10.12 SEBI'S Annual Accounts

SEBI (Form of Annual Statement of Accounts and Records) Rules, 1994 were notified by the Central Government on 20th May, 1994 in consultation with Comptroller and Auditor General of India, in exercise of the powers conferred by Section 15(1) read with Section 29 of SEBI Act, 1992. Rule 3 prescribes that at the expiration of a period of 12 months ending with 31st March every year, SEBI shall prepare with reference to that period, a balance sheet, income and expenditure account and receipts and payments account as on the last working day of that period respectively in the forms - Form A, Form B and Form C respectively. Rules 4 and 5 prescribe that SEBI shall preserve these statements for a minimum period of five years and that they shall be signed by the Chairman and an officer authorised by SEBI.

The accounts of SEBI shall be audited by the Comptroller & Auditor General of India (C&AG) and SEBI shall pay the C&AG for the services rendered. The C&AG or his authorised persons shall have the same rights, privileges and authority in connection with such audit as the C&AG has in connection with audit of government accounts and in particular shall have the right to demand the production of books, accounts, connected vouchers and documents and papers and to inspect any of the offices of SEBI. The accounts of SEBI as certified by the C&AG together with the audit report shall be forwarded annually to the Central Government who shall cause the sameto be laid before each House of Parliament.

10.13 Securities Appellate Tribunal (Procedure) Rules, 2000

In exercise of the powers conferred by section 29 read with section 15T and 15U of the Securities and Exchange Board of India Act, 1992 the Central Government notified Securities Appellate Tribunal (Procedure) Rules, 2000.

- **Limitation for Filing Appeal**

Rule 3 dealing with Limitation for filing appeal requires every appeal to be filed within a period of forty five days from the date on which a copy of the order against which the appeal is filed, is received by the appellant. However, Appellate Tribunal has been empowered to entertain an appeal after the expiry of the said period of forty five days if it is satisfied that there was sufficient cause for not filing it within that period.

- **Procedure for Filing Appeal**

Rule 4 requires a memorandum of appeal to be presented in the prescribed Form by any aggrieved person in the registry of the Appellate Tribunal within whose jurisdiction, his case falls or be sent by registered post addressed to the Registrar. A memorandum of appeal sent by post shall be deemed to have been presented in the registry on the day it was received in the registry.

- **Sittings of Appellate Tribunal**

Rule 5 dealing with settings of Appellate Tribunal requires the Tribunal to hold its sitting either at a place where its office is situated or at such other place falling within its jurisdiction, as it may deem fit by the Appellate Tribunal. In the case of temporary absence of the Presiding Officer, Government may authorize one of the two other Members to preside over the sitting of the Tribunal either at a place where its office is situated or at such other place falling within its jurisdiction as it may deem fit by the Appellate Tribunal.

- **Fees and Documents to Accompany Memorandum Appeal**

Rule 9 lays down that every memorandum of appeal to be accompanied with a fee and such fee may be remitted in the form of crossed demand draft drawn on any nationalised bank in favour of "the Registrar, Securities Appellate Tribunal" payable at the station where the registry is located. The amount of fee payable in respect of appeal against adjudication orders made under Chapter VI A of the Act has been prescribed as given below :

Amount of penalty imposed Amount of fees payable

1. Less than rupees ten thousand Rs. 500
2. Rupees ten thousand or more but less than one lakh Rs. 1,200
3. Rupees one lakh or more Rs. 1,200 plus Rs. 500 for every additional one lakh of penalty or fraction thereof, subject to a maximum of Rs. 1,50,000

Amount of fee payable in respect of any other appeal against an order of the Board under the Act shall be rupeesfive thousand only. Rule 10 requires every memorandum of appeal filed to set forth concisely under distinct heads, the grounds of such appeal without any argument or narrative, and such ground shall be numbered consecutively. Separate memorandum of appeal is not required to seek interim order or direction if in the memorandum of appeal, the same is prayed for. Rule 11 provides that every memorandum of appeal shall be in five copies and shall be accompanied with copies of the order, at least one of which shall be certified copy, against which the appeal is filed. Where a party is represented by authorised representative, a copy of the authorisation to act as the authorised representative and the written consent thereto by such authorised representative shall be appended to the appeal. Rule 12 makes it clear that a memorandum of appeal shall not seek relief or reliefs therein against more than one order unless the reliefs prayed for are consequential.

- **Appeal to be in Writing**

Rule 7 requires every appeal, application, reply, representation or any document filed before the Appellate Tribunal to be typewritten, cyclostyled or printed neatly and legibly on one side of the good quality paper of foolscap size in double space and separate sheets to be stitched together and every page to be consecutively numbered and filed in five sets in a paper book along with an empty file size envelope bearing full address of the respondent and in case the respondents are more than one, then sufficient number of extra paper books together with empty file size envelope bearing full addresses of each respondent shall be furnished by the appellant.

- **Notice of Appeal to the Respondent and Filing of Reply**

Rule 13 requires the Registrar to serve on the respondent a copy of the memorandum of appeal and paper book as soon as they are registered in the registry, by hand delivery, or by Registered Post or Speed Post. The respondent may file five complete sets containing the reply to the appeal along with documents in a paper book form with the registry within one month of the service of the notice on him of the filing of the memorandum of appeal. The Appellate Tribunal may, in its discretion, on application by the respondent allow the filing of reply after the expiry of the period of one month. Every reply, application or written representation filed before the Appellate Tribunal should be verified in the prescribed manner. A copy of every application, reply, document or written material filed by the respondent before the Appellate Tribunal shall be forthwith served on the appellant, by the respondent.

- **Hearing of Appeal**

The Appellate Tribunal shall notify the parties the date of hearing of the appeal in such manner as the Presiding Officer may by general or special order direct. On the day fixed or on any other day to which the hearing may beadjourned, the appellant shall be heard in support of the appeal. The Securities Appellate Tribunal shall, then, if necessary, hear the Board or its authorised representative against the appeal, and in such case the appellant shall be entitled to reply. During the course of the hearing of appeal the written arguments could be supplemented by time-bound oral arguments. However, in the case of temporary absence of the Presiding Officer or of the Member authorized by the Government under sub-rule (2) of rule 5, the Presiding Officer can authorize the other Member present on that day to hear the Board or authorized representative against the appeal.

In case the appellant does not appear in person or through an authorised representative when the appeal is called for hearing, the Securities Appellate Tribunal may dispose of the appeal on merits. However, where an appeal has been disposed of as aforesaid and the appellant appears afterwards and satisfies the Securities Appellate Tribunal that there was sufficient cause for his not appearance, when the appeal was called for hearing, the Securities Appellate Tribunal shall make an order setting aside the ex-parte order and restore the appeal.

- **Order of the Appellate Tribunal**

Every order of the Appellate Tribunal shall be pronounced in the sitting of the Appellate Tribunal by the Presiding Officer or in case of the temporary absence of the Presiding Officer, by the authorized Member and powers be signed and dated by the Presiding Officer. The Presiding Officer has to pass interim orders or injunctions, subject to reasons to be recorded in writing, which it considers necessary in the interest of justice. In terms of Rule 19 the orders of the Appellate Tribunal, as are deemed fit for publication in any authoritative report or the press may be released for such publication on such terms and conditions as the Presiding Officer may lay down. Under Rule 20, a certified copy of every order passed by the Appellate Tribunal shall be

communicated to SEBI, the Adjudicating Officer and to the parties, as the case may be. Students are advised to refer to SAT cases which are available on SEBI website www.sebi.gov.in.

- **Inspection of Records and Copies Thereof**

Rule 22 which deals with fee for inspection of records and copies thereof prescribes a fee of rupees twenty, for every hour or part thereof of inspection subject to a minimum of rupees one hundred for inspecting the records of a pending appeal by a party thereto. Similarly a fee of rupees five for a folio or part thereof not involving typing and a fee of rupees ten for a folio or part thereof involving typing of statement and figures has been prescribed for providing copies of the records of an appeal, to a party thereto.

10.14 Summary

SEBI has twin objectives of protecting the interests of the investors and to promote the development of, and to regulate the securities markets by such measures as it thinks fit. SEBI regulates the securities market and SAT acts as a watchdog to ensure justice. Section 15 Y of the SEBI Act provides that no civil court shall have jurisdiction to entertain a suit or proceeding in respect of any matter in which an adjudicating officer (`AO') is appointed under the Act or SAT is empowered by or under the Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the Act. The SEBI Act, 1992 empowers for appellate remedies against SEBI's order or penalties by establishing Securities Appellate Tribunal. Any person aggrieved by any decision or order of the SAT can file an appeal to Supreme Court. Appearance before SAT may be either in person or through authorized person being a Chartered Accountant, Company Secretary, Cost Accountant or Legal Practitioner. To regulate the working of SAT for dealing with matters with the SEBI Act, the Securities Appellate Tribunal (Procedure) Rules, 2000 came into force.

10.15 Self Assessment Questions

1. What are the prime objectives of SEBI?
2. Discuss the various powers and functions of the SEBI.
3. Explain the role of SEBI in strengthening regulatory framework and fostering investor confidence.
4. Enumerate the various penalties which can be imposed under SEBI Act, 1992 for various failures, defaults, non-disclosure and other offences.
5. Explain the procedure for Appeal to the Securities Appellate Tribunal.
6. Discuss the various powers of the Central Government under SEBI Act, 1992.
7. Explain the functions and duties of the Registrar under the Securities Appellate Tribunal (Procedure) Rules, 2000.

Unit : 11- Investors' Protection

Structure of Unit:

11.0 Objectives

This unit will enable the students to understand:

- The concept and need for Investor Protection and Education.
- Rights and responsibilities of investors
- Legal framework for investor protection in India
- Measures taken for financial literacy in India and SEBI initiatives, etc.

11.1 Introduction

Investor protection focuses on making sure that investors are fully informed about their purchases, transactions and the affairs of the company that they have invested in. Investors protections is a very popular phrase with all these concerned with regulation of the capital market these days, be the stock exchanges. SEBI, MCA, RBI, Investors Association, or for that matter of fact the companies themselves – Various Procedures, Guidelines, Rules and Regulations have been issued in the Legislations to protect the 'Investors' right and repose the confidence.

The securities market operations promote the economic growth of the country. More efficient is the securities market, the greater is the promotion effect on economic growth. It is, therefore, necessary to ensure that securities market operations are more efficient, transparent and safe. In this context, the investors need protection from the various malpractices and unfair practices made by the corporate and intermediaries. As the individual investors' community and the investment avenues are on the rise, it is interesting to know how the investors shall be protected through various legislations. Securities market in general are to be regulated to improve the market operations in fair dealings and easy to access the market by corporate and investors. The present positive attitude of investors is heartening though investor sentiments have been shaken by the various scandals. Even though, there are various opportunities available for investment, investors are scared of investing. In this situation, the individual investors' protection becomes necessary to sustain the economic development of the country.

The global concern to make capital markets safer and transparent can be achieved by strengthening financial system and managing the crisis efficiently. The revival of investors' protection in the corporate securities market is necessary to make market more efficient by means of converting savings to investment. If the investors are not protected properly by way of providing fair rate of return and safeguarding their capital, the corporate will not be able to mobilize funds from the market at reasonable rate in times to come. In view of the foregoing with a view to gain the confidence of investors in the securities market it is necessary to provide adequate rate of return on investors' capital by corporates through their operational efficiency. This will enable us to lure back investors to the capital market. This can be done by a series of systematic measures which would build their confidence in the systems and processes and protect the interest of investors.

11.2 Legal Framework for Investor Protection in India

In order to afford adequate protection to the investors, provisions have been incorporated in different legislations such as the Companies Act, Securities Contracts (Regulation) Act, Consumer Protection Act, Depositories Act, and Listing Agreement of the Stock Exchanges supplemented by many guidelines, circulars and press notes issued by the Ministry of Finance, Ministry of Company Affairs and SEBI from time to time. The legislations as well as the rules and regulations notified there under specify disclosure requirements to be complied with by the companies and also punishments and remedies for failure of compliance.

- **Companies Act, 1956**

Acceptance of Deposits

Section 58 A - This section provides that no Company shall invite any public deposits without issuing an advertisement in accordance with the Companies (Acceptance of Deposit) Rules, 1975. In the said advertisement the Company is under obligation to indicate its financial position as also details about the Company's business, Board Directors etc. A copy of the said advertisement has to be filed with the Registrar of Companies. In terms of sub-section 9 where a Company fails to repay any deposit or part thereof, the Company Law Board may either on its own or on the application of the depositors, by order direct the Company to make re-payment of such deposits thereof forthwith or within such time and subject to such conditions as may be specified in the order. Sub-section 10 provides for penalty in the case of failure to comply with any order made by the Board under sub-section 9.

Section 58AA: In this Section the Companies Act has recognized that a small depositor means a depositor who has deposited in a financial year a sum not exceeding `20,000/- in a company and includes its successors,nominees and legal representatives. This section inter alia, provides that in case of any default made by a company in the re-payment of such deposits and part thereof or interest thereon, it shall give an intimation within60 days about such default to the Company Law Board (CLB).It is also provided that upon default in re-payment to small depositors, no company shall accept any further deposits from small depositors until the matured deposits and interest accrued thereon have been paid fully.

Mis-statements in Prospectus

Section 63: This Section deals with criminal liability for misstatement in prospectus issued by a company. For such misstatements, the section provides for imprisonment upto 2 years which and fine which may extend to ` 50,000/- or with both and the offence is compoundable.

Section 68: This section deals with the penalty for fraudulently inducing persons to invest money in security of a company and provides for imprisonment upto 5 years or find upto `1 lakh.

Non-payment of Dividend

Section 205: This section, inter alia, requires a company who has declared a dividend for any financial year to deposit the amount of such dividend (including interim dividend, if any) in separate bank account within 5 days from the date of declaration of such dividend.

Section 205A: This section provides that where a dividend has been declared by a company which has not been paid or claimed within 30 days from the date of such declaration, the company shall within 7 days of expiry of the said period of 30 days transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by a company in this behalf. This section also provide for penalty for non complying with the above requirement and the same by way of interest @ 12% on the amount of unpaid/unclaimed dividend not transferred to the special account. Section 205C: This section provides for establishment of Investors' Education and Protection Fund by the Central Government. Various types of unpaid/unclaimed amounts of application money/matured deposits/matured debenture etc. are to be credited to the said fund. The said accumulation in this fund are to be utilized for promotion of investors' awareness and protection of investors' interests.

Transfers and Transmission of Securities

Regarding transfers and transmissions of securities necessary provisions are available in Section 111, 111A and 113 of the Companies Act. As regards listed companies, the clauses in the listing agreement contain provisions for prompt issue of certificates after effecting transfers. Failure to comply with the provisions of Companies Act can be brought before the Company Law Board through an appeal under Section 111 and 111A. After hearing the parties Company Law Board may by order direct the company to register the transfer.

Failure to Send Financial Statements

Section 219: This section provides for the right of a member for copies of Balance-sheet and auditors Report. Sub-section 3 makes the default in complying with this requirement punishable with fine which may extend to `5,000/-. Besides, Section 621 of the Companies Act, 1956 permits the shareholder to proceed against the company and its officers in a court of law generally for offences committed under the Companies Act including prospectus, abridged prospectus, allotment, listing, transfer of shares, dividend payment etc. committed by the company as well as its officers under various provisions in the Act.

Protection to Debenture holders

Section 117A to 117C protect the debenture holders, and the new sections contains stringent punishments for default.

SEBI ACT, 1992

In the preamble to the SEBI Act, 1992 two objectives are mentioned. The first objective is protecting the interest of the investors in securities and the second is to promote the development of and to regulate the securities market and for matters connected therewith or incidental thereto. Thus priority is accorded to investor protection in the SEBI Act. Section 11 in Chapter IV of the SEBI Act lists out the functions of the SEBI. There are 15 functions provided forSEBI in this section. Section 11(2)(e) stipulates prohibition of fraudulent and unfair practices relating to securities markets as one of these functions and Section 11(2)(g) provides for prohibition of insider trading in securities. In pursuance of this provision the Board had notified the SEBI (Prohibition of fraudulent and unfair practices relating to securities markets) Regulations, 1995 on 25th October, 1995 in exercise of Section 30 of SEBI Act which empowers SEBI to make regulations for different purposes of the Act. These regulations have now been replaced with SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 w.e.f. 17.7.2003. Section 15A to Section 15HA provide for penalty in respect of failure to furnish information, return, etc., failure by any person to enter into agreement with clients, failure to redress investors' grievances, certain defaults in case of mutual funds, failure to observe rules and regulations by an asset management company, default in case of stock brokers, insider trading, non-disclosure of acquisition of shares and takeovers, fraudulent and unfair tradepractices.

Section 24 provides for punishment with imprisonment upto 10 years or with fine which may extend to `25 crores or with both. If any person contravenes or attempts to contravene or abets the contravention of the provision of SEBI Act or any rules or regulation. As regards violation of provisions in the listing agreement, investors can forward their complaints to the stock exchanges with whom the company is listed to initiate action. The Investors are also at liberty to file complaints before the District Forum, State Commission or National Commission established under Section 9 of the Consumer Protection Act. In the case of listed companies investors are entitled to forward their complaints to the company and SEBI and the latter takes up the matter with the companies. SEBI has the power to take action including criminal proceeding where necessary against persons responsible for delay.

Powers under the Companies Act, 1956

SEBI has delegated powers to take action against listed companies under 45 Sections of the Companies Act in relation to issue and transfer of securities and non-payment of dividend. SEBI is empowered to deal with violations and defaults under Sections 55 to 58, 59 to 84, 108 to 110, 112 & 113, 116 to 122, 206 and 206A & 207, committed by listed companies as well as public companies which intend to make public issues and get their securities listed on any recognised stock exchange. Under Section 209A, officers of SEBI are also authorised to undertake inspection of books of the company in regard to matters covered under Section 55A, and SEBI neednot give previous notice to the company in this regard.

Securities Contracts (Regulation) Act, 1956

Section 23 provides for penalties which may extend to 10 years or with fine which may extend to `25 crores or with both for contravention of the provisions of the Act. Section 23A to Section 23H provide for penalty in respect of failure to furnish information, return etc., failure by any person to enter into an agreement with clients, failure to redress investor grievances, failure to segregate securities or moneys of client or clients, failure to comply with provisions of listing conditions or delisting conditions or grounds, excess dematerialization or delivery of unlisted securities, failure to furnish periodical returns, contravention with any provision of the act where no separate penalty is provided.

Section 23M provides for penalty for imprisonment for a term which may extend to 10 years or with fine which may extend to `25 crore or both for contravention or attempts to contravene or abates the contravention of the provisions of the Act or any rules or regulations or bylaws.

Reserve Bank of India Act, 1938

Section 45 QA of the Reserve Bank of India Act gives a depositor similar rights as are provided under Companies Act to approach CLB for payment of matured deposits in the case of NBFCs

Indian Penal Code

Economic Offence Wings of the Police Departments have powers under IPC to take up the cases of cheating, forgery and misappropriation etc. relating to investments. Stock exchanges can also take up the issues pertaining to securities in terms of the conditions of listing agreement, rules and regulations.

11.3 Investor Education and Protection Fund

Investor Education and Protection Fund (IEPF) has been established under Section 205C of the Companies Act, 1956 by way of Companies (Amendment) Act, 1999, for promotion of investors' awareness and protection of the interests of investors. Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 (IEPF Rules) stipulate the activities related to investors' education, awareness and protection for which the financial sanction can be provided under IEPF.

(i) Activities stipulated under Rules

– Education programme through Media

– Organizing Seminars and Symposia

– Proposals for registration of Voluntary Associations or Institution or other organizations engaged in Investor Education and Protection activities

– Proposals for projects for Investors' Education and Protection including research activities and proposals for financing such projects

– Coordinating with institutions engaged in Investor Education, awareness and protection activities.

(ii) Activities undertaken by IEPF

– Educating and creating awareness among investors through Voluntary associations or organizations registered under IEPF.

– Educating investors through Media, Conducted panel discussions on DD (Delhi, Mumbai, Kolkata,Chennai and Ahmedabad), Telecast of TV Video spots on DD & private channels, print advertisement in national as well as regional newspapers. All these programmes have been undertaken in Hindi, English and regional languages:

– Organizing seminars and workshops through associations registered under IEPF.

– Financing research projects pertaining to investor education, awareness.

– Coordinating with institutions engaged in investor education, awareness – Indian Institute of Capital Markets (IICM) has been engaged for conducting research/study on unclaimed dividend, interest etc. and also conducting "Training of Trainers" programme.

11.4 SEBI (Investor Protection and Education Fund) Regulations, 2009

SEBI in exercise of the powers conferred by section 30 of SEBI Act, 1992, SEBI made the SEBI (Investor Protection and Education Fund) Regulations, 2009. Regulation 3 of the Act lays down the establishment of the fund which shall be called the Investor Protection and Education Fund. Regulation 4 provides for the amounts to be credited to the Fund. The following amounts shall be credited to the Fund:-(a) contribution as may be made by SEBI to the Fund; (b) grants and donations given to the Fund by the Central

Government, State Government or any other entity approved by SEBI for this purpose; (c) proceeds in accordance with the sub-clause (ii) of clause(e) of sub-regulation (12) and the sub- regulation (13)of regulation 28 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997; (d) security deposits, if any, held by stock exchanges in respect of public issues and rights issues, in the event of de-recognition of such stock exchanges; (e) amounts in the Investor Protection Fund and Investor Services Fund of a stock exchange, in the event of de-recognition of such stock exchange; (f) interest or other income received out of any investments made from the Fund; (g) such other amount as SEBI may specify in the interest of investors.

- **Utilisation of Fund**

The fund shall be utilised for the purpose of protection of investors and promotion of investor education and awareness in accordance with these regulations. The fund may be used for the following purposes, namely:-(a) Educational activities including seminars, training, research and publications, aimed at investors; (b) Awareness programmes including through media - print, electronic, aimed at investors;(c) Funding investor education and awareness activities of Investors' Associations recognized by SEBI (d) Aiding investors' associations recognized by SEBI to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed; (e) Refund of the security deposits which are held by stock exchanges and transferred to the Fund consequent on de-recognition of the stock exchange, in case the concerned companies apply to SEBI and fulfill the conditions for release of the deposit; (f) Expenses on travel of members of the Committee, who are not officials of the Board, and special invitees to the meetings of the Committee, in connection with the work of the Committee;(g) Salary, allowances and other expenses of office of Ombudsman; and (h) Such other purposes as may be specified by SEBI.

- **Conditions for Aid**

The aid shall be given by SEBI to investors' associations, in accordance with the guidelines made by it and subject to the following conditions:

(a) that the aid shall not exceed seventy five per cent. of the total expenditure on legal proceedings; (b) such aid shall not be considered for more than one legal proceeding in a particular matter; (c) if more than one investors' association applies for seeking legal aid, the investors' association whose application is received first, shall be considered for such aid.

- **Constitution of The Committee**

SEBI shall constitute an advisory committee for recommending investor education and protection activities that may be undertaken directly by the Board or through any other agency, for utilisation of the Fund for the purposes referred in these regulations. The Committee shall consist of the following members, namely:-(a) The Executive Director of SEBI in charge of Office of Investor Assistance and Education who shall be the convener of the Committee; (b) Two other officials of SEBI;(c) Five other members who have expertise about the securities market and experience in matters of investor grievance redressal or investor education. The term of office of members shall be two years, which may be extended for a further period of two years. Any vacancy arising out of resignation, retirement or death of a member or for any other reason shall be filled by the Board for the remaining period of the term of such member. SEBI may dissolve and reconstitute the Committee if, at any time, SEBI is of the opinion that the Committee is unable to discharge the functions and duties imposed on it by or under these regulations.

11.5 Financial Education

An increased need for financial education is felt in both developed and developing countries. In developed countries, the increasing number of financial products, its complexity, importance of retirement savings, increased growth of secondary market has made the imparting of financial education imperative for all age groups, including students so that individuals are educated about financial matters as early as possible in their lives. In the developing countries, the growing number of investors, technically advanced financial markets, liberalized economy etc. necessitates imparting of financial education for better operation of markets and economy and in the interest of investor. Further imparting of financial education is international concern due to growth of international transactions, international financial instruments like ADR, GDR, IDR etc., mobility of individuals from one country to another etc.

11.6 Investors' Rights and Responsibilities

Equity shareholders are the real owner of the company and with the growth of the company equity shareholders also get capital appreciation, vice versa is also true. Investment in equity shares cannot be guaranteed with any income and/or growth. Following are the rights and responsibilities of a shareholder of a company :

<u>The Rights of Investor as a shareholder</u>:

– To receive the share certificates, on allotment or transfer (if opted for transaction in physical mode) as the case may be, in due time. Now in IPO investors will be allotted shares in dematerialized mode any and subsequently they can dematerialized the allotted shares.

– To receive copies of the Annual Report containing the Balance Sheet, the Profit & Loss account and the Auditor's Report.

– To participate and vote in general meetings either personally or through proxy.

– To receive dividends in due time once approved in general meetings.

– To receive corporate benefits like rights, bonus, etc. once approved.

– To apply to Company Law Board (CLB) to call or direct the calling of an Annual General Meeting.

– To inspect the minute books of the general meetings and to receive copies thereof.

– To proceed against the company by way of civil or criminal proceedings.

– To apply for the winding up of the company.

– To receive the residual proceeds in case of winding up.

– To receive offer to subscribe to right share in case of further issue of shares.

– To receive offer in case of Takeover or Buy-back under SEBI Regulations.

– Besides the above rights, which investors enjoy as an individual shareholder, investors also enjoy the following rights as a group:

– To requisition an Extra-ordinary General meeting.

– To demand a poll on any resolution.

– To apply to CLB to investigate into the affairs of the company.

– To apply to CLB for relief in cases of oppression and/or mismanagement.

Rights of Investors as a debenture holder:

– To receive interest on redemption of debentures in due time.

– To receive a copy of the trust deed on request.

– To apply for winding up of the company if the company fails to pay its debt.

– To approach the Debenture Trustee with your grievance.

– You may note that the above mentioned rights may not necessarily be absolute. For example, the right to transfer securities (in physical mode) is subject to the company's right to refuse transfer as per statutory provisions.

Responsibilities of an Investor as a security holder:

– To be specific

– To remain informed

– To be vigilant

– To participate and vote in general meetings

– To exercise your rights on your own or as a group.

- **Whom to Approach for Complaint against Stock Brokers/Depository Participants**

Investors who are not satisfied with the response to their grievances received from the brokers/Depository Participants/listed companies, can lodge their grievances with the Stock Exchanges or Depositories. The grievance can be lodged at any of the offices of the BSE/NSE located at Chennai, Mumbai, Kolkata and New Delhi. In case of unsatisfactory redressal, BSE/NSE has designated Investor Grievance Redressal Committees (IGRCs), or Regional Investor Complaints Resolution Committees (RICRC), this forum acts as a mediator to resolve the claims, disputes and differences between entities and complainants. Stock Exchanges provide a standard format to the complainant for referring the matter to IGRC/RICRC. The committee calls for the parties and acts as a nodal point to resolve the grievances. For any detailed information, please visit the website of the respective stock exchange. If the grievance is still not resolved, an investor can file arbitration under the Rules, Bye laws and Regulations of the respective Stock Exchange/Depository.

11.7 Grievances and Dealing Authority

Grievances pertaining to Regulator Banks deposits and banking Reserve Bank of India (RBI) http://www.rbi.org.in/ Fixed Deposits with Non Banking Financial Companies (NBFCs) and other matters pertaining to NBFCs Primary Dealers Fixed Deposits with manufacturing companies Ministry of Corporate Affairs (MCA) http://www.mca.gov.in/ Unlisted companies Mismanagement of companies, financial performance of the company, Annual General Meeting, Annual Report, minority shareholders interest, non-receipt of preferential allotment shares, etc. and corporate actions as per the court order such as mergers, amalgamation, reduction of share capital/par value, etc. Nidhi Companies Insurance Companies/Brokers /Agents/products Insurance Regulatory and Development Authority of and Service India (IRDA) http://www.irdaindia.org/ Commodities Forward Markets Commission (FMC) http://www.fmc.gov.in/ Pension fund Pension Fund Regulatory and Development Authority (PFRDA) http://www.pfrda.org.in/ Monopoly and anti competitive practices Competition Commission of India (CCI) http://www.cci.gov.in/ Chit Funds Registrars of Chit Funds of the concerned State. Housing Finance Companies National Housing Bank (NHB) www.nhb.org.in

11.8 Initiatives on Financial Literacy in India

(a) RBI's initiatives

Reserve Bank of India has undertaken a project titled "Project Financial Literacy". The objective of this project is to disseminate information regarding the central bank and general banking concepts to various target groups, including school and college students, women, rural and urban poor, defense personnel and senior citizens. The project envisages a multi pronged approach. The project has been designed to be implemented in two modules, one module focusing on the economy, RBI and its activities, and the other module on general banking.

The material is created in English and other vernacular languages. It is disseminated to the target audience with the help of banks, local government machinery, schools and colleges through presentations, pamphlets, brochures, films and also through RBI's website.

(b) SEBI Initiatives

Securities Exchange Board of India has embarked financial education on a nationwide campaign. To undertake financial education to various target segments viz. school students, college students, working executives, middle income group, home makers, retired personnel, self help groups etc., SEBI has empanelled Resource Persons throughout India. The Resource Persons are given training on various aspects of finance and equipped with the knowledge about the financial markets. These SEBI Certified Resource Persons organise workshops to these target segments on various aspects viz. savings, investment, financial planning, banking, insurance, retirement planning etc. Investor education programs are conducted by SEBI through investor associations all over the country. Regional seminars are conducted by SEBI through various stakeholders viz. Stock Exchanges, Depositories, Mutual Funds Association, Association of Merchant Bankers etc. SEBI has a dedicated website for investor education wherein study materials are available for dissemination. SEBI also publishes study materials in English and vernacular languages. Under "Visit SEBI” programme, School and college students are encouraged to visit SEBI and understand its functioning. SEBI has recently set up SEBI Helpline in 14 languages wherein through a toll free number, investors across the country can access and seek information for redressal of their grievances and guidance on various issues.

(c) IRDA has also brought out publications of 'Policyholder Handbooks' as well as a comic book series on insurance. A dedicated website for consumer education in insurance is on the verge of launch IRDA's Integrated Grievance Management System (IGMS) creates a central repository of grievances across the country and provides for various analyses of data indicative of areas of concern to the insurance policyholder.

(d) PFRDA Initiatives on Financial Education

The Pension Fund Regulatory and Development Authority, India's youngest regulator has been engaged in spreading social security messages to the public. PFRDA has developed FAQ on pension related topics on its web, and has been associated with various non government organizations in India in taking the pension services to the disadvantaged community. PFRDA's initiatives have become more broad-based with direct mass publicity on NPS - both as individual model through POPs and group models through Aggregators. PFRDA has issued advertisements in print media and electronic media through radio and television. PFRDA appointed intermediaries are called Aggregators who are directly responsible for pension awareness mostly in vernacular languages and in line with socio-economic sensibilities.

Investor Grievance Redressal Mechanism

There will be occasions when an investor has a complaint against, a listed company or an intermediary registered with SEBI. In the event of such complaint, the investor should first approach the concerned company/ intermediary against whom there is a complaint. Sometimes the response received may not be satisfactory. Therefore, investors should know as to which authority they should approach, to get their complaints redressed.

11.9 SCORES (SEBI COMPLAINTS REDRESS SYSTEM)

SCORES is a web based centralized grievance redress system of SEBI (http://scores.gov.in). SCORES enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere. This enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online. All the activities starting from lodging of a complaint till its closure by SEBI would be online in an automated environment and the complainant can view the status of his complaint online. An investor, who is not familiar with SCORES or does not have access to SCORES, can lodge complaints in physical form at any of the offices of SEBI. Such complaints would be scanned and also uploaded in SCORES for processing.

The salient features of SCORES are:

- SCORES is web enabled and provides online access 24 x 7;
- Complaints and reminders thereon can be lodged online at the above website at anytime from anywhere;
- An email is generated instantaneously acknowledging the receipt of complaint and allotting a unique complaint registration number to the complainant for future reference and tracking;
- The complaint forwarded online to the entity concerned for its redressal;
- The entity concerned uploads an Action Taken Report (ATR) on the complaint;
- SEBI peruses the ATR and closes the complaint if it is satisfied that the complaint has been redressed adequately;
- The concerned investor can view the status of the complaint online from the above website by logging in the unique complaint registration number;
- The entity concerned and the concerned investor can seek and provide clarification on his complaint online to each other;
- Every complaint has an audit trail; and
- All the complaints are saved in a central database which generates relevant MIS reports to enable SEBI to take appropriate policy decisions and or remedial actions, if any.

- **How to lodge complaint in SCORES?**

To register a complaint online on SCORES portal, (http://scores.gov.in) click on “Complaint Registration” under “Investor Corner”. The complaint registration form contains personal details and complaint details. There are certain mandatory fields in the Form. These fields include Name, Address for correspondence, State, Email Address of Investor. After filling the personal details, select the complaint category, entity name, nature of complaint related to, complaint details in brief (up to 1000 characters). A PDF document (up to 1MB of size for each nature of complaint) can also be attached along with the complaint as the supporting document. On successful submission of complaint, system generated unique registration number will be displayed on the screen which may be noted for future correspondence. An email acknowledging the complaint with complaint registration number will also be sent to the complainant's email id entered in the complaint registration form.

- **What are the limitations in dealing with complaints?**

Sometimes a complaint is successfully resolved and the entity is advised to send reply to complainant. But in certain cases, the entity or company denies wrongdoing, and it remains unclear as to who is wrong or whether any wrongdoing occurred at all. If this happens, SEBI cannot act as a judge or an arbitrator and force the entity or company to resolve the complaint. Further, SEBI cannot act as personal representative or attorney of the complainant. Securities laws and other laws provide important legal rights and remedies if an investor has suffered wrongdoing. On their own, investors can also seek to resolve their complaint through the courts, consumer courts, or arbitration.

- **When can a case be referred for arbitration?**

If the grievance is not resolved by the Stock Exchange/Depository due to disputes, an investor can file arbitration subject to the Bye-laws, Rules and Regulations of the exchange / Depository. All claims, differences or disputes between the investors and stock brokers/depository participants can be filed for arbitration. To obtain information about when and how to file an arbitration claim, please visit:Bombay Stock Exchange http://www.bseindia.com/invdesk/Arbitrage.asp National Stock Exchange http://www.nseindia.com/content/assist/asst_investser.htm Central Depository Services Limited http://www.cdslindia.com/downloads/Operating%20Instruction/Chapters-as-of-June-2011.pdf National Securities Depository Limited https://nsdl.co.in Simplified arbitration can be a less costly alternative to legal recourse before the courts of law. If the investor has an account with the broker or a depository participant (DP), he/she can choose arbitration to settle disputes. The investor generally cannot pursue an issue through arbitration if it is barred by limitation prescribed. When deciding whether to arbitrate, the investor has to bear in mind that if the broker or DP goes out of business or declares bankruptcy, he/she might not be able to recover money even if the arbitrator or court rules in his/her favor.

However, with certain restriction to the nature of transactions, Stock Exchanges may settle on case to case basis the claim of an investor up to a limit prescribed in the "Investor protection fund" guidelines of the respective Stock Exchange. The claimant is required to carefully review the rules governing simplified arbitration before filing a claim and should also weigh the costs of arbitrating against the likelihood of being able to collect any award in favor. An investor, who has a claim / counter claim upto `10 lakh and files arbitration reference for the same within six months, need not make any deposit for filing arbitration.

- **When can SEBI take action for non resolution of the complaint?**

While the entity is directly responsible for redressal of the complaint, SEBI initiates action against recalcitrant entities on the grounds of their unsatisfactory redressal of large number of investor complaints as a whole.

Which are the matters that are not considered as complaints by SEBI?

– Complaints that are incomplete or not specific

– Allegations without supporting documents

– Offering suggestions or seeking guidance/explanation

– Seeking explanation for non-trading of shares or illiquidity of shares

– Not satisfied with trading price of the shares of the companies

– Non-listing of shares of private offer

– Disputes arise out of private agreement with companies/intermediaries.

11.10 Summary

In order to afford adequate protection to the investors, provisions have been incorporated in different legislations such as the Companies Act, Securities Contracts (Regulation) Act, Depositories Act, and Listing Agreement of the Stock Exchanges supplemented by many guidelines, circulars and press notes issued by the Ministry of Finance, Ministry of Company Affairs and SEBI from time to time. Investor Education and Protection Fund (IEPF) has been established under Section 205C of the Companies Act, 1956 by way of Companies (Amendment) Act, 1999, for promotion of investors' awareness and protection of the interests of investors. SEBI issued SEBI (Investor Protection and Education Fund) Regulations, 2009 to protect the interest of investors and provide for the utilization of the fund established under these regulations. In the developing countries, the growing number of investors, technically advanced financial markets, liberalised economy etc. necessitates imparting of financial education for better operation of markets and economy and in the interest of investor. SEBI has also launched a comprehensive securities market awareness campaign for educating investors through workshops, audio-visual clippings, distribution of educative investor materials/booklets, dedicated investor website etc. SCORES is a web based centralized grievance redress system of SEBI which enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the above website from anywhere.

11.11 Self Assessment Questions

1. Explain the investors rights and responsibilities as an individual shareholder and as a group.
2. Outline the various statutory measures initiated by MCA for investor protection.
3. What is SCORES? Briefly discuss the salient features of SCORES.
4. Explain the utilisations of Investor Protection and Education Fund established under the SEBI (Investor Protection and Education Fund) Regulations, 2009.
5. Who are eligible to make a request under the SEBI (Informal Guidances) Scheme, 2003?