BLOCK III:
CAPITAL MARKET

Unit 1 : Capital Market- Its Nature, Scope and Functions

Unit 2 : Types of Capital Market, Equity Market, Debt Market, IPOs and Private Placement

Unit 3 : Capital Market Reforms

Unit 4 : Secondary Market- Stock Exchanges, their Functions, Trading Mechanism

Unit 5 : Security Depositories and Its Benefits- NSDL and CDSL

Unit-1
Capital Market- its Nature, Scope and Functions

Unit Structure:

1.1 Introduction
1.2 Objectives
1.3 Capital Market
1.4 Nature & Scope of Capital Market
1.5 Features of Capital Market
1.6 Functions of Capital Market
1.7 Summing Up
1.8 Model Questions
1.9 References and Suggested Readings

1.1 Introduction

Capital Market is one of the important constituent of the financial system. A good capital market is an essential pre-requisite for industrial and commercial development of a country. The Capital market promotes economic growth by mobilizing the funds from the surplus sector and channelizing it in the deficit sector. Surplus sector or units refers to those who have surplus or excess income and want to invest it in lieu of some returns. On the other hand, deficit sector or units refers to those who have deficit income (expenditure is more than income). Capital market mobilizes long term savings available in the surplus sector and channelizes the same for long term investment.

1.2 Objective

After going through this unit, you will be able to

- *understand* the concept of Capital Market,
- *explain* the features of Capital Market,
- *discuss* the functions of Capital Market.

1.3 Capital Market

Capital Market is a financial market which deals with long term securities i.e. debt and equity. It is a financial market where long-term debt or equity-backed securities are bought and sold. The market provides avenues for long term investment of surplus fund. In widest sense, it consists of a series of channels through which the savings are made available for industrial, commercial enterprises and public authorities.

A Capital Market may be defined as an organised mechanism for effective and efficient transfer of money capital or financial resources from the investing parties, i.e. individuals or institutional savers to the entrepreneurs (individuals or institutions) engaged in industry or commerce or in the business either be in the private or public sectors of an economy.

Capital markets are classified as primary market and secondary market. A market where securities are sold for the first time is called primary market. This market plays very important role in tapping the unutilized resource leading to capital formation. Secondary Market is a market where the already existing securities are bought and sold. Secondary market provides liquidity to those securities which are sold in the primary market. Secondary market is popularly known as share market or stock market. In India, SEBI regulates the capital market.

Check Your Progress

1. Define Capital Market.
2. Capital Market deals in __________________ term capital.

1.4 Nature & Scope of the Capital Market-

An efficient capital market is a pre-requisite of economic development. An organised and well developed capital market

i) Ensures best possible coordination and balance between the flow of savings on the one hand and the flow of investment leading to capital formation on the other;

ii) Directs the flow of savings into most profitable channels and thereby ensures optimum utilisation of financial resources.

Thus, an ideal capital market is one where finance is used as a handmade to serve the needs of the industry. The capital market must facilitate the movement of capital to the point of highest yield. Hence a capital market strives for –

i) Mobilisation or concentration of national savings for economic development and

ii) The mobilisation and import of foreign capital and investment to augment the deficit in the required financial resources so as to maintain the expected rate of economic growth.

Stop to Consider

The Securities and Exchange Board of India (SEBI) is responsible for the protection of investors' interests and ensuring orderly development of the capital market. SEBI was constituted as the regulator of capital market in India in 1988. After the enactment of SEBI Act by parliament in 1992,SEBI was given autonomous and statutory power.

1.5 Features of Capital Market

The important features of the Capital Market are as follows-

1. Serves as a link between savers and investors.

Capital market serves as a crucial link between saving and investment process as it transfers money from savers to entrepreneurial borrowers.

2. Deals in medium and long term Investment:

The capital market deals with medium and long term financial instruments. Investable funds are transferred through instruments such as shares, debentures and bonds.

3. Promotes Capital formation:

Capital formation occurs through the creation of saving, the mobilisation of savings and the investment of savings. Capital market mobilise such savings through IPOs and issuance of the bonds in the primary market. Such mobilisation of savings leads to capital formation.

4. Presence of intermediaries:

Capital market operates with the help of intermediaries such as brokers, underwriters, merchant bankers, government and private financial institutions etc.

5. **Types of Investors**: Capital market has both individual and institutional investors such as mutual funds, insurance companies, financial institutions etc

6. Rules and Regulations:

The capital market operates under the rules, regulation and policies framed by the Government from time to time. SEBI is the regulator of capital market in India.

Check Your Progress

1. State the important features of Capital Market.
2. Mention the different types of investors in Capital Market.
3. Who is the regulator of Capital market in India?

1.6 Functions of Capital Market

While from a broader perspective, Capital Markets is viewed as a market of financial assets with long or infinite maturity, it actually plays a very important role in mobilizing resources and allocating them to productive channels. So it can be said that the process of economic growth of a country is facilitated by the Capital Markets. The important functions and significance of the markets have been discussed below: –

1. Link between savers and investors: The capital market functions as a link between the savers and investors. It plays an important role in mobilising the savings and diverting them in productive investment. Thus, capital market plays a vital role in transferring the financial resource from surplus and wasteful areas to deficit and productive areas and increases the productivity and prosperity of the country.

2. Promotes Saving Habits: The development of Capital Markets, the taxation system, and the banking institutions provide facilities and provisions which encourages the investors to save more. In the absence of Capital Markets, they might have invested in unproductive assets like land or gold or might have indulged in unnecessary spending.

3. Promotes Investment: The capital markets both the primary and secondary provides various investment avenues to those who have kept aside certain savings from their income. This savings are invested in various avenues including shares, debentures, bonds etc.

4. **Promotes Economic Growth**: Saving leads to investment and well planned investment leads to economic development. The capital market not only promotes savings and investment but also smoothens and accelerates the process of economic growth. The proper allocation of resource results in the expansion of trade and industry in both public and private sectors thus promoting balanced economic growth in the country.

5. **Stable and Systematic Security prices:** Apart from the mobilization of funds, the Capital Markets helps to stabilize the prices of stocks. Reduction in the speculative activities and providing capital to borrowers at a lower interest rate help in the stabilization of the security prices.

Stop to Consider

Some differences between Money Market and Capital Market

Money Market	Capital Market
Commercial banks, non-financial institutions, central banks, chit funds, etc.	Stockbrokers, insurance companies, Commercial banks, underwriters, etc.
Money markets are highly liquid	Capital markets are comparatively less liquid.
Money markets have low risk.	Capital markets are riskier in comparison to money markets.
Instruments mature within a year.	Instruments take a longer time to attain maturity
To achieve short-term credit requirements of the trade.	To achieve long-term credit requirements of the trade.
Increasing liquidity of funds in the economy	Stabilizing the economy by an increase in savings

Check Your Progress

1. Write a brief note on the different functions of Capital Market.
2. State the role of Capital market in the economic growth of the country?

1.7 Summing Up

Capital market is an important constituent of financial system.Its a market for medium term and long term fund. Capital market is further classified as Primary market and secondary market. Primary market is also known as new issue market, where the securities are issued for the first time. Primary market plays an important role in the capital formation. Secondary market is also known as Share market or stock market. This market deals in already issued or existing securities. As discussed, capital market promotes savings and investment and helps in the economic growth of the country.

1.8 Model Questions

1. What is Capital Market?
2. Discuss the important functions of Capital Market.
3. Discuss the nature or objective of Capital market.
4. Highlight the important features of Capital market.
5. Explain how Capital Market helps in achieving high economic growth?

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Unit-2

Types of Capital Market, Equity Market, Debt Market, IPOs and Private Placement

Unit Structure:

2.1 Introduction

2.2 Objectives

2.3 Types of Capital Market

2.4 Primary Market

 2.4.1 Participants of Primary Market

 2.4.2 Types of issuance in the primary market

 2.4.3 Function of Primary market

2.5 Secondary Market

 2.5.1 Functions of Secondary Market

2.6 Equity Market

2.7 Debt Market

2.8 IPO

 2.8.1 Types of IPO

 2.8.2 Advantages of IPO

 2.8.3 Disadvantages of IPO

2.9 Private Placement

 2.9.1 Advantages of Private Placement

2.10 Summing Up

2.11 Model Questions

2.12 References and Suggested Readings

2.1 Introduction

Capital markets are classified as primary market and secondary market. A market where securities are sold for the first time is called primary market. This market plays very important role in tapping the unutilized resource leading to capital formation. It is also known as new issue market. Secondary Market is a market where the already existing securities are bought and sold. Secondary market provides liquidity to those securities which are

sold in the primary market. Secondary market is popularly known as share market or stock market

2.2 Objectives

After going through this unit you will be able to–

- *understand* the types of capital market,
- *discuss* the features of Primary and Secondary market,
- *explain* Equity market , Debt market, IPOs and Private placement.

2.3 Types of Capital Market

Capital market is mainly categorized into two sub markets: Primary Market or New Issue Market and Secondary Market or Share Market.

2.4 Primary Market

The primary market mainly deals with new securities that are issued in the stock market for the first time. It is a market where new securities i.e. shares or bonds that have never been previously issued are offered. Thus, it is also known as the new issue market. Primary market mobilise fresh capital from the market and plays a very important role in the capital formation. Both new companies and the existing ones can raise capital on the new issue market. The primary market is considered as the most important type of capital market. The prime function of the new issue market is to facilitate the transfer of funds from the willing investors to the entrepreneurs setting up new corporate enterprises or going in for expansion, diversification, growth or modernisation. The companies raise funds in the primary market through public issue, right issue and preferential allotment.

2.4.1 Participants of Primary Market

Primary Market or New issue market has different types of participants

a) The Issuing Entity: These are the entities that issue the new securities in the primary market. They include companies and corporations, government entities and other organizations.

b) The Underwriters: Underwriters help companies prepare for their new issues. They undertake the responsibility of acquiring any unsold

shares of the company, if it is unable to sell the required number of shares to investors publicly.

c) The Intermediaries: Intermediaries include various entities like banks, brokers, dealers and other financial institutions that help facilitate the issue of new securities in the primary market.

d) The Market Regulators: Market regulators are bodies like the Securities and Exchange Board of India (SEBI) that oversee the functioning of the primary market. They ensure that the issue follows all the regulations in place.

e) The Investors: The main investors in this type of market are individuals, corporate, financial institutions, banks, HNIs (High Net worth Individuals), etc.

2.4.2 Types of issuance in the primary market

The primary market or new issue market mobilise fresh capital from the market .In order to mobilise funds, the new issue market makes the following offers or issues:

a) Initial Public Offering (IPO): An IPO is the first issue of a company's shares to its public. It allows the company to make the transition from a private company to a listed entity.

b) Follow-On Public Offering (FPO): Any further issue of shares by a company to the public following the IPO is termed as an FPO. These issues also occur in the primary market.

c) Rights Issue: A rights issue is the issue of shares by a company to its existing shareholders. These issues are typically made at a discounted price, and shareholders have the option (but not the obligation) to exercise their rights to purchase the company's shares at the reduced price.

d) Bonus Issue: A bonus issue is also an issue of shares by a company to its current shareholders. Here, the shares are offered free of charge as a reward to the company's shareholders, or to increase liquidity among the company's shares in the market.

e) Preferential Allotment: Preferential allotment involves issuing shares to a select group of investors at preferential or discounted rates.

Companies resort to this kind of issue in the primary market to raise capital quickly and more affordably.

e) Offer for Sale- This method of marketing securities is generally adopted in case of large issues by companies. Under this method, the issuing companies sell or agrees to sell the securities for sale to certain issue houses or the specialised financial institutions at a fixed price.

2.4.3 Function of Primary market

- Mobilising fresh capital::The primary market gives companies a regulated space to raise capital for their business by issuing new stocks and/or bonds. The funds generated through such issues make it easier for issuing companies to meet the financial requirements of their business.
- Transfer of ownership: Primary market gives the promoters the opportunity to transfer the ownership to the public by issuing equity shares
- Price Discovery: Primary market helps the new company in the process of price discovery. In this process the underwriters makes it easier to identify the initial price of a company's security based on the forces of demand and supply in the market. This process of price discovery is crucial to any company that is launching a fresh issue of securities.
- Investment Opportunities: Primary markets provide investors with the opportunity to invest in newly issued stocks and bonds. These opportunities are not available in the secondary market, where only the stocks of previous listed companies are traded. For investors seeking to diversify their portfolio with the stocks of new companies, the primary market is highly beneficial.

Check Your Progress

1. Discuss the types of Capital market.
2. What is a Primary Market?
3. Primary market is also known as______________________

4. State the basic functions of Primary Market?
5. What is E-IPO?
6. Discuss the different method or techniques adopted for raising capital in the Primary Market.
7. State the advantages of Primary Market.
8. State few disadvantages of Primary Market.
9. What is Private Placement of shares?
10. What is Offer for Sale method?

2.5 Secondary Market or Stock Exchange

Secondary market or Stock market is the market where trading takes place for the already existing securities. It is known as stock exchange or stock market. Secondary Market is a place where the existing securities are bought and sold. The main point of difference between the primary and the secondary market is that in the primary market only new securities are issued, whereas in the secondary market the trading is done for already existing securities or the securities which are already issued in the primary market. There is no fresh issue of shares or securities in the secondary market, so there is no question of fresh capital. Secondary Market provides liquidity to the securities already issued in the primary market. In India, secondary market consists of recognised stock exchange operating under rules, by-laws and regulations duly approved by the government.

Sec 2(3) of the Securities Contract (Regulation) Act, 1956 defines stock exchange as "any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling in securities."

2.5.1 Functions of Secondary Market or Stock Exchange

Some of the Important Functions of Stock Exchange/Secondary Market are listed below:

- ***Economic Barometer:***

  A stock exchange is a reliable barometer to measure the economic condition of a country. Every major change in country and economy is

reflected in the prices of shares. The rise or fall in the share prices indicates the boom or recession cycle of the economy. Stock exchange is also known as a pulse of economy or economic mirror which reflects the economic conditions of a country.

- Pricing of Securities:

  The stock market helps to value the securities on the basis of demand and supply factors. The securities of profitable and growth oriented companies are valued higher as there is more demand for such securities. The valuation of securities is useful for investors, government and creditors. The investors can know the value of their investment, the creditors can value the creditworthiness and government can impose taxes on value of securities.

- ***Safety of Transactions:***

  In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company. The companies which are listed they also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.

- ***Contributes to Economic Growth:***

  In stock exchange securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

- ***Spreading of Equity Cult:***

  Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.

- ***Providing Scope for Speculation:***

  To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities.

- ***Liquidity:***

  The main function of stock market is to provide ready market for sale and purchase of securities. The presence of stock exchange market gives assurance to investors that their investment can be converted into cash whenever they want. The investors can invest in long term

investment projects without any hesitation, as because of stock exchange they can convert long term investment into short term and medium term.

- ***Better Allocation of Capital:***

  The shares of profit making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market. The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor's fund to profitable channels.

- ***Promotes the Habits of Savings and Investment:***

  The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive

Check Your Progress

1. Define Secondary Market.
2. State the important features of Secondary Market
3. Discuss the important functions of Secondary Market
4. Secondary Market is also known as ______________________
5. State the trading mechanism of dealing in the Stock Exchange.

2.6 Equity Market

An equity market is a platform for purchasing and selling equities or stocks of various listed companies. Various traders purchase and sell shares in the equity market. It is a place for buying and selling of a company's stocks with the help of a stockbroker. The first step for trading in stock exchanges is to have a Demat and trading account and select a trusting stockbroker to open a Demat Account.

2.7 Debt Market

Debt market is a place where fixed income securities are bought and sold. Various debt instruments such as debentures, bonds, Government securities

are bought and sold in Debt Market. The debt market is associated with low risk compared to equity market. The debt market acts as a regular source of income and capital preservation. The returns from the debt market are very often low as compared to the returns from equity market.

In the equity market, the participants buy and sell shares. Whereas in the debt market, bonds, certificates of deposits, debentures, and government securities are bought and sold.

Stop to Consider

Equity market and Debt Market are integral part of the Capital Market. Both these market constitute the Capital Market. Equity Share, Debentures, Bonds are the few of the prime instruments that are dealt in these market. The return is fluctuating in equity market as return largely depends upon the profit they earn, however, the return from debt market is stable and regular as investment are made upon debt instruments.

Check Your Progress

1. What is Equity Market?
2. What is Debt Market?
3. What instruments are dealt in Debt Market? Explain.
4. Discuss the trading procedures of Equity Market.

2.8 IPO

IPO is the acronym of Initial Public Offering. By definition, it is the process by which a privately held company offers its shares to the public for the first time to become a publicly traded company. It is a process of offering of either a fresh issue of securities or an offer for sale of existing or both by an unlisted company for the first time to the public. As by issuing the IPO the company gets its name listed on the stock exchange. It's also termed as "going public".

2.8.1 Types of IPO

Fixed price offering: - Under fixed price, the company going public determines a fixed price at which its shares are offered to the investors. The investor knows the share price before the company goes public. To participate in the IPO, the investor must pay the full shares price when making the application.

Book Building Offering: - Under book building, the company going public offer a 20% price band on share to investor. Investor then bid on the share before the final price is settled once the bidding has closed. Investors must specify the number of share they want and how much they are willing to pay. Unlike a fixed price offering, there is a fixed price per share. The lowest price of share is known as fair price, while the highest share is known as the cap price. The final price is determined by using investor bids.

2.8.2 Advantages of IPO Offerings

Raising capital from investors.

The primary reason for a company to go for public offering is raising fresh capital from the market. The company may need more money to pay off debts, to expand the business, to improve infrastructure and for many such reasons which they think will help in their future development.

Lower Cost of Capital:

IPO enables the company to raise capital at lower cost than the market rate. If the company borrows money from banks, they will charge interest on it. But if the company raises capital by issuing shares that there would be no obligation to provide any interest on that raised money.

Increases Liquidity:

The shareholders after being allotted shares through IPO, hold them in the form of equities. The shareholder can sell the share in the secondary market once the company is listed in any recognised stock exchange. Thus , the investors get increased liquidity for their investment.

Helps in Mergers and Acquisitions:

When a larger public company enters into a deal for an acquisition or a merger with smaller competitors, the terms of the deal typically include

shares. This way cash flow to the smaller companies gets smoother and effective.

Increases Visibility and Credibility:

Going public increases the visibility and credibility of a company. In a public company, one can expect a better management and more transparency in fiscal data as they have to periodically report it to governing bodies.

Improves Financial Health:

Selling equities to the public would have generated a lot of capital and increases liquidity, which will be used for the better future of the company. Hence, the company will gradually approach towards a better financial situation, to apply for a loan or to negotiate the terms of the loans.

2.8.3 Disadvantages of IPO Offering

High Upfront Cost:

Offering shares to the public is not at all cheap; it has a huge upfront cost. It involves underwriter's fees, accounting and legal fees, registration charges, printing charges, and advertising costs etc. Moreover, the accounting system and management have to be upgraded.

Loss of Ownership Control:

Going Public means, you could lose ownership control of the business. If you somehow become a minor shareholder, the Board of Directors could even fire you.

Lower Control over Decision Making Process

In a public company, any major decision needs to be passed by taking approvals from the majority of the shareholders. When you sell too much of your stakes outside the company, and your shareholders elect the majority of the board of directors, decision-making process may take days to complete or even be rejected in case of disagreement between broad of directors.

Increased Liability

A public company is legally obligated to its shareholders to capitalize on shareholder profits and announce operational data. There is no way you can provide an excuse for any mismanagement. The company and its management can even be prosecuted for misrepresentations of information

to shareholders or for omitting information that the country's securities laws require being disclosed.

2.9 Private Placement

Section 42 of the Companies Act, 2013 ('Act') provides that a Company can make a private placement to a select group of persons. Private Placement by companies means offering its securities or inviting to subscribe its securities for a select group of persons other than by way of public issue through a private placement offer letter.

Private placement of securities can be made only to select persons or identified persons (as identified by the board of the company). A company making a private placement cannot offer its securities through any public advertisements or utilise any marketing, media, or distribution agents to inform the public about such an offer.

Under this method the securities are sold by the issuing companies to certain intermediaries such as brokers, issue houses or financial institutions, etc. so as to privately place to their clients and associates. The issuing company may also use their service for private placement to certain individuals or institutions without having sold such securities to the intermediaries.

The main advantage of this method is that it is very cheap way of marketing securities as it saves in issuing costs but the securities are sold to only a selected group of investors.

2.9.1 Advantages of Private Placement

The following are the advantages of private placement:

1. **Speed in raising finance**: If a company goes in for a fresh issue through public issue there are lot of procedures to be followed which take a lot of time. On the other hand, it is possible to raise resources through private placement within 1 or 2 months.
2. **Low cost**: The company need not spend money in preparation and printing of prospectus, printing of application forms, transporting them to different places, advertisements of the issue in the media etc
3. **Confidentiality**: The Company can maintain strict confidentiality. In the case of issue through prospectus many disclosures have to be made.

But in the case of private placement disclosures made are less and they are made to a select few. Therefore confidentiality can be maintained.

4. **Small amounts can be raised**: Even small amounts can be raised through private placement.

5. **Stable market**: The private placement market is more stable when compared to the stock markets. Volatility is less and issues are marketed in a professional manner.

Stop to Consider

IPO and Private Placement are two important methods adopted by the corporate houses while issuing shares in the Primary market. IPO or Initial Public Offering is the process by which a privately held company offers its shares to the public for the first time to become a publicly traded company. It is a process of offering of either a fresh issue of securities or an offer for sale of existing or both by an unlisted company for the first time to the public.

Private Placement is that method the securities are sold by the issuing companies to certain intermediaries such as brokers, issue houses or financial institutions, etc. so as to privately place to their clients and associates

Check Your Progress

1. Define IPO.
2. What do you mean by Private Placement of Shares?
3. Discuss the advantages and disadvantages of IPO.
4. State the benefits for adopting Private Placement of shares by corporate.
5. State the different types of IPO.

2.10 Summing Up

1. A market where securities are sold for the first time is called primary market. Secondary Market is a market where the already existing securities are bought and sold. Secondary market provides liquidity to those securities which are sold in the primary market. Secondary market is popularly known as share market or stock market

2. The primary market mainly deals with new securities that are issued in the stock market for the first time. It is a market where new securities i.e. shares or bonds that have never been previously issued are offered. Thus, it is also known as the new issue market. Primary market mobilise fresh capital from the market and plays a very important role in the capital formation.

3. In the secondary market the trading is done for already existing securities or the securities which are already issued in the primary market. There is no fresh issue of shares or securities in the secondary market, so there is no question of fresh capital

3. The primary market or new issue market mobilise fresh capital from the market through Initial Public Offering (IPO),Preferential Allotment, Rights Issue, Bonus Issue , Offer for Sale and Follow-On Public Offering (FPO)

4. An equity market is a place for buying and selling of a company's stocks with the help of a stockbroker. The first step for trading in stock exchanges is to have a Demat and trading account and select a trusting stockbroker to open a Demat Account.

5. Various debt instruments such as debentures, bonds, Government securities are bought and sold in Debt Market. The debt market is associated with low risk compared to equity market. In the equity market, the participants buy and sell shares. Whereas in the debt market, bonds, certificates of deposits, debentures, and government securities are bought and sold.

2.11 Model Questions

1 What do you understand by 'New Issue Market'? Explain the different methods of marketing corporate securities.

2 Define Secondary Market or Stock Exchange. Discuss the different important functions of a Stock Exchange.

3 State the trading mechanism of dealing in the Stock Exchange.

4 What do you mean by IPO. Discuss the advantages and disadvantages of IPO.

5 What do you understand by Private Placement of Shares? State the advantages of Private Placement of shares.

2.12 References and Suggested Readings

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Unit -3
Capital Market Reforms

Unit Structure:

3.1 Introduction
3.2 Objectives
3.3 Need for Financial Reforms
3.4 Objectives of Financial Reforms Introduced in 1991
3.5 Reforms in the Capital Market
3.5.1 Primary Market Reforms
3.5.2 Secondary Market Reforms
3.5.3 Government Securities Market Reforms
3.5.4 Derivatives Market Reforms
3.6 Major outcome of capital market reforms
3.7 Summing Up
3.8 References and Suggested Readings
3.9 Model Questions

3.1 Introduction

Financial sector reforms aim to enhance the allocative efficiency of all the players and constituents of financial sector, which is believed to be essential for achieving optimal competitive efficiency. The primary focus of financial sector reforms was to establish efficient and stable financial institutions and markets, eliminate structural obstacles, introduce new participants and instruments, implement free pricing of financial assets, ease quantitative restrictions, enhance trading, clearing and settlement practices, boost institutional infrastructure, refine market microstructure, generate liquidity, efficient price discovery, and ensure technological advancement. The first-generation reforms aimed to restore fundamental balance and stimulate prosperity. Second generation reforms refer to a series of steps required for a nation to achieve consistent high-quality economic development. Second generation reforms are often seen as exploring more deeply into sector-specific details. They are essentially small-scale changes related to a certain area of operation.

3.2 Objectives

After going through this unit ,you will be able to

- Understand the needs of Financial Reforms
- Know the objectives of Financial Reforms
- Discuss the various reforms in the Capital Market.

3.3 Need for Financial Reforms

The purpose of financial sector reforms is to establish an efficient financial system that will improve the allocative efficiency of resources, promote financial inclusion, protect confidence in the financial system and ensure financial stability. Financial reforms were necessary due to the poor condition of financial institutions and markets. The banking industry faced challenges such as limited competition, insufficient capital, poor productivity, and high intermediation expenses. Technology had a little role, and the service quality was not given sufficient attention. The risk management system was not adhered to properly, and the prudential requirements were inadequate.

All these factors led to a decline in the quality of assets. Development financial institutions functioned in a sheltered atmosphere with most of the capital coming from guaranteed sources. Competition was minimal in the insurance and mutual fund sectors. Financial markets were distinguished by the regulation of financial asset pricing, obstacles to market entrance, and elevated transaction expenses. The banks were operating at loss or extremely low earnings, which hindered their ability to cover loan defaults and strengthen their capital. There were organizational shortcomings, weakened management and control functions, increased restrictive practices, deteriorating work culture, and credit management faults. The banks' performance was strained due to a high cash reserve ratio (CRR), statutory liquidity ratio (SLR), and focused programs for priority industries with below-market lending rates. This has negatively impacted profitability and led to low interest rates on deposits and higher interest rates on loans for bigger borrowers in various sectors. Cross-subsidization was inherent in the system. Concessional rates given to some industries were offset by charging higher rates to non-concessional borrowers.

The financial sector's successes, financial health, integrity, autonomy, flexibility, and vitality have declined significantly during the last many years. Resource allocation has become significantly skewed, leading to a decline in portfolio quality and a reduction in productivity, efficiency, and profitability

within the system. The customer service was poor, the work technology was antiquated, and the transaction prices were excessive. The system had a poor capital basis, inadequate accounting, and transparency standards, and significantly increased administrative overheads. Many believed that these issues were caused by policy-induced rigidities, centralized administrative control over investment and credit allocations, internal bank management, extensive branch expansion, overstaffing, union pressures, and excessive political intervention. An alarming rise of disease inside the Indian financial system necessitated immediate corrective actions or reforms, which were implemented in 1991.

3.4 Objectives of Financial Reforms Introduced in 1991

1. To establish a market-driven, competitive, globally inter-connected, diverse, autonomous, and transparent financial system.

2. To enhance the allocative efficiency of existing savings and stimulate rapid expansion in the real sector.

3. To enhance efficiency, accountability, profitability, sustainability, vitality, balanced expansion, operational efficiency, adaptability, professionalism, and governance in the financial industry.

4. To enhance the actual investment's rate of return.

5. To foster competition by establishing fair competition conditions and enabling unrestricted access for institutions and market participants.

6. To guarantee the rationalization of interest rates structure, it is important that interest rates be flexible, market-determined, or market-related, and that the system provides users with a suitable level of positive real interest rates. Simply put, the aim has been to destroy the regulated system of interest rates. The aim has been to eliminate the regulated system of interest rates.

7. To decrease resource preemptions and enhance the efficiency of directed credit programs.

8. To establish a financial infrastructure including supervision, audit, technology, and legal aspects.

9.To update monetary control instruments for better alignment with market economies by shifting towards indirect or market-based tools rather than direct or physical ones.

3.5 Reforms in the Capital Market

The 1991-92 securities scam prompted the government to increase the pace of reforms in the capital market. The government has taken several measures to develop the capital market in the post-reform period, since then in both the primary and secondary segments of the equity market. With which the capital market reached new heights. Some of the important measures which the government undertook to reform the capital market can be divided into Primary market reforms and Capital Market Reforms which are as follows: -

3.5.1 Primary Market Reforms

Reforms in Primary market are highlighted in the following points.

- SEBI (Securities Exchange Board of India) was established as a non-statutory body under administrative management in early 1988. The Securities and Exchange Board of India (SEBI) was established in January 1992 with statutory powers to regulate the securities market. Investor protection and orderly capital market development are the two goals outlined in the SEBI Act.
- In May 1992, the capital issues (control) act of 1947 was repealed, allowing issuers of securities to raise capital from the market without the approval of any authority, either for floating or pricing an issue. There were also no restrictions on the rights and bonus issues. The debenture interest rate was lowered. However, new capital issues are now subject to SEBI oversight, and issuers must adhere to SEBI disclosure and protection guidelines, which are being strengthened overtime to protect investors' interests.
- As many mutual funds sponsored by banks and financial institutions were set up in 1987-88, the process of institutionalization on the supply side began to gain momentum in the early 1990s when mutual funds were established privately. A total of more than Rs 1 lakh crore is now held by 37 mutual funds operating in the country.
- The requirement to issue shares with a par value of Rs 10 and Rs 100 was canceled. • This allowed companies to set a fixed value for each share of stock. Those companies that have dematerialized their shares can use this service. Shares cannot be issued in decimal rupees, either. Also eligible for splitting and consolidating share values are companies that have already issued shares at a value of Rs 10 or Rs 100.

• Simplified issue procedures and improved disclosure standards have been mandated. As part of the process of launching public offerings, companies are required to disclose all material facts about their projects, as well as specific risk factors associated with those projects. For public issues, the SEBI does not vet the offer document, but it has introduced a code of advertisement for public issues to ensure fair and truthful disclosures.

• As a cost-saving measure, the issuer made underwriting optional. However, if an issue is not underwritten and fails to secure 90% of the public offering, the entire sum collected will be refunded to investors.

• For unlisted companies, the existing requirement of a three-year track record of dividend payment for an IPO has been relaxed under the new norms, the companies will have to demonstrate an ability to pay dividends rather than an actual dividend-paying record.

• Any fund-based activity that is not directly related to the capital market is prohibited for merchant bankers. The term "merchant banker" is no longer used to describe a variety of different types of merchant bankers.

• Other intermediaries, such as mutual funds, portfolio managers' registrars to an issue, share transfer agents, underwriters, and debenture trustees have also been brought under the purview of the Securities and Exchange Board of India.

• Bridge loans to companies against expected equity flows /issues for periods not exceeding one year and loans against shares held by banks to promoters of new companies in anticipation of raising resources have been permitted since 1998-99, within the 5 percent ceiling prescribed for banks investment shares. The bank's board of directors must give their approval. It is no longer necessary to impose a 50 percent minimum margin on personal loans secured by corporate preference shares and debenture bonds. However, the 50 percent margin for equity shares has remained unchanged. Dematerialized securities' minimum margin prescription was reduced from 50% to 25%, and the ceiling amount on advances against shares to individuals has raised from Rs 10 lakh to Rs 20 lakh as a result.

• To avoid misleading the public, mutual funds have been issued with a code of conduct on advertising.

• By modifying the disclosure and investor protection (DIP) guidelines, the entry norms for IPOs have been tightened. There have been three IPOs worth five times the pre-issue value of Rs 1 crore in the past 15 years, according to the new guidelines Book building is the only option for

companies with less than five times their pre-issue net worth to raise money through an initial public offering. 60% of the issue must be allocated to qualified institutional investors (QIBs). If the project has been appraised by public institutions and not less than 5% of the project cost is financed by any of the institutions, either jointly or separately, by way of loans and/or equity subscriptions, the requirements of eligibility norms are exempt.

• The SEBI (DIP) (Disclosure and Investor Protection) Guidelines, 2000 have been amended. Permission has been granted to foreign venture capital investors (FVCIs) registered with the SEBI and state industrial Development Corporations to participate in public issues through the book building route as qualified institutional buyers(QIBs). There is a lock-in requirement for the pre-issue capital of an unlisted company held by venture capital funds (VCFs) and FVCIs. Exemption from the public offer requirement in view of a reduction in quantum from 25 percent to 10 percent and restriction of a minimum public issue size of Rs. 25 crores in respect of an IPO through the book building issue have been removed.

• In March 2003, the SEBI introduced sweeping changes in IPO norms to boost investor confidence. It changed the eligibility criteria for IPOs- a track record of distributable profits was replaced by net tangible assets as it felt that profit figures could be fudged. According to the new norms, companies floating IPOs should have net tangible assets of Rs 3 crore in each of the two preceding two years. Of this, not more than 50percent be held in monetary assets –cash or its equivalent such securities. It is now mandatory for companies to change their names to ensure that a minimum of 50 percent of the total revenues are derived from the business activity suggested by the new name.

• On March 29, 2005, the SEBI redefined the retail individual investor as one who applies or bids for securities of or for a value not exceeding Rs 1 Lakh. It hiked allocation to high-net-worth individual's book-built issue from 25 percent to 35 percent and reduced allocation to high net worth individuals (Non-Institutional) Category. The allocation to high-net-worth investors was reduced to 15 percent from 25 percent. The market regulator also reduced the bidding period for a book-built issue. The SEBI reduced the bidding period from the current 5- 10 days (including holidays) to 3-7 working days. It has given an option to listed issuers to either disclose price band in a red herring prospectus /an application form/an abridged prospectus or to disclose price band/floor price at least one day before the opening of the bid. To improve the content and ensure uniformity in data display on the

websites of the stock exchanges, the data will be available for a further period of 3 days after the closure of the bid/issue. The new norms apply to all public issues whose offer documents are filed with SEBI on or after April 4, 2005.

- For issues priced below Rs 500 per share, the face value should mandatorily be Rs 10 per share but if the issue price is 500 or more, the minimum face value should not be below Rs 1

- Shares will now be allotted on a proportionate basis within the specified categories, with the predetermined minimum allotment being equal to the minimum application size.

- During 2005-06 SEBI disclosure and investor protection (DIP) guidelines, 2000 relating to book-building issues were amended to introduce a specific allocation of 5 percent for a mutual fund, proportionate allotment to Qualified Institutional Buyer (QIBs), and margin requirement for QIBs.

- To ensure the availability of floating stocks continuously and maintain uniformity for continuous listing, a minimum public shareholding of 25 percent was prescribed by SEBI in the case of all companies barring a few exceptions.

- To assist the retail investors, SEBI gave in-principal approval for grading of IPOs by the rating agencies at the option of the issuers. SEBI will not certify the assessment made by the rating agencies.

- Companies in the IT, telecom, media, and entertainment sectors are permitted to raise capital by offering at least 10% of their equity. To be eligible for this route, a public offering must have a minimum issue size of Rs 100 crore, using the book-building method with a 60% allocation to qualified institutional buyers (QIBs), and maintain a continuous minimum floating post-listing stock.

- Only in Demat form can the issuer make a public or rights offering of shares. Both physical and dematerialized securities can be purchased by investors.

- The SEBI issued new guidelines to govern corporate debt security's private placements. These guidelines are designed to increase transparency and protect the interests of investors in debt securities.

- A new IPO price stabilization tool, the green-shoe option facility, was introduced by SEBI.

- The central listing authority was established to ensure that securities are listed on stock exchanges in a uniform and standard manner.

• ECS was made available to all refunds from the public issue to expedite and ease the process of refunds.

• Even after a prospectus for an IPO or public offer has been filed with the regulator, companies are allowed to pursue multiple avenues to raise capital simultaneously. Companies are now only required to update their prospectus with information about additional capital that is being raised through other means. – With this new leniency, businesses will be able to plan their capital-raising campaigns.

• After the initial public offering (IPO), venture capital and private equity firms cannot sell their shares in accompany. If you invested more than a year before the company went public, you are no longer allowed to sell your shares on the market.

• Previously, at least two credit rating agencies were required for public/ rights issues of debt instruments. Now, one credit rating agency will suffice. To lower the cost of issuing debt instruments, this was done.

• Investors will be able to purchase bonds that are not rated investment-grade to meet their risk/return preferences. Investment grade had previously been the minimum standard.

• SEBI amended the DIP guidelines to allow listed companies to raise equity through rights and follow-on issues in a short period. Fast track issues are those involving publicly traded companies, and they are governed by specific rules.

• With the permission of SEBI, companies can now offer discounts of up to ten percent to retail investors in public offerings. This will help companies increase their equity holdings while also generating a positive response from retail investors during this period of stagnant primary market activity.

• The minimum investment in Indian depository receipts (IDRs) has been reduced from Rs 200000 to Rs 20000, making IDRs available to all investors, including retail investors.

• A new payment system called ASBA (Application Supported by Blocked Amount) was launched by SEBI in August 2008 for public and human rights issues.

• PAN is required for all public and civil rights applications, regardless of the amount requested. Mandatory PAN Requirements for opening and operating beneficial owner (BO) accounts with depository participants and for trading in the cash, the market has been waived in the state of Sikkim by SEBI.

• The minimum offer to the public norms has been revised to make regulatory requirements consistent across companies regardless of post-issue capitalization and to assist mid-sized issuers who may not require large funds.

• Public companies must have at least 25 percent of their shares owned by the general public by August 22, 2017, as a minimum.

Check Your Progress

1) List down any five important changes that SEBI has brought in the last five years.

2) What do the following stand for?

SEBI :

SIB :

SEC :

3) Briefly explain the need for self-regulation in monitoring security market dealings.

3.5.2 Secondary Market Reforms

• The open outcry trading system, which was in use until 1995, was replaced by online screen-based trading. Approximately 8000 trading terminals are dispersed across the country among the country's 23 stock exchanges.

• Over-the-counter exchange of India (1992), national stock exchange of India (1994), and interconnected stock exchange of India (1995) were all established in the 1990s. (1999)

• In August 1996, the trading and settlement cycles of all stock exchanges were reduced from 14 days to seven days. In January 1998, a dematerialized segment of all companies was introduced to rolling settlement (T+5). Since December 31, 2001, all stocks have been settled on a rolling basis. On April 1, 2002, the settlement cycle was shortened for all securities from T+5 to T+3.

• Additionally, various risk-containment measures such as the market to margin system, intraday trading limit, and trade guarantee fund have been implemented or strengthened. Before declaring members default, the stock exchange is allowed to use settlement guarantee funds (SGFs) to cover shortfalls caused by non-fulfillment or partial fulfillment of their obligations.

The NSE has established a separate corporation, the National Securities Clearing Corporation, to act as a counterparty to all trades executed in the exchange's capital market segment.

• Securities dematerialization through the depository system and electronic book-entry transfers are being investigated vigorously to improve investor protection. In November 1996, the National Securities Depositories Limited and the Central Depositories Limited were established to make this possible. Demat accounts are used to hold, trade, and settle all actively traded securities.

• The SEBI Act, 1992, prohibits insider trading and punishes it as a criminal offense, making it a violation of the insider trading regulations.

• To ensure that stock exchange requirements were uniform, the government amended the Securities Contract Regulation Rules in 1957.

• A carry-forward mechanism, based on the Patel and Varma committee recommendations from 1995, was reinstituted in Badla in January 1996. (1996). Mandatory delivery under negotiated deals, securities lending, and continuous net settlement were all implemented to strengthen the cash segment. Following the March 2001 scam, all deferral products, including badla, were halted as of July 2001.

• Under the listing agreement, all listed companies must provide stock exchanges with continuous disclosures and publish quarterly unaudited financial results. There must be public disclosure of material information that could affect a company's ability to operate effectively.

• Corporate governance reform is one of the most significant measures in the secondary education sector. The purpose of corporate governance is to safeguard the interests of the company's various stakeholders. Commitment to values, ethical business practices, and a high level of openness are all key components. All stakeholders must be protected while the interests of shareholders are maximized. The SEBI appointed Kumar Mangalam Birla as chairman of a committee to study Indian corporate governance. Codes for corporate governance were drafted by the committee, and stock exchanges were suggested as the best method of implementation.

• Major structural changes have also been made to stock exchanges. A wide range of interests is represented on the boards of various stock exchanges, rather than just those represented by their members. The Securities and Exchange Board of India (SEBI) has taken over the regulation of stock exchanges, brokers, and sub-brokers.

• Companies are permitted to buy back their shares for capital restructuring, provided that the buyback does not exceed 25% of the company's paid-up capital and free reserves. This buyback has been allowed to improve liquidity and increase shareholder wealth.

• The insider trading regulations have been formulated prohibiting insider trading and making it an offense, punishable following the provision under the SEBI act, 1992.

• Takeover and substantial acquisition of shares are governed by rules that ensure the interests of small shareholders are protected while also increasing transparency in the process.

• Takeovers were revised in September 2002 after SEBI accepted recommendations from the Bhagwati committee. To comply with the new code, an acquirer must make open offers to the stockholders of both companies if it gains control of more than 15% of the shares of a company that already owns 15% of the shares. If management control changes, an open offer will be made even if the equity stake is less than 15%. Withdrawn shares can be sold in the open market or to another acquirer who is willing to pay more for them. It's now mandatory to reveal the percentage of a company's stock that an acquirer holds at various levels of acquisitions. To ensure complete transparency in the acquisition process, the buyer must make disclosures for every 2% increase in the holding's value above the 15% threshold.

• Over-trading and sudden increases in the price of securities have been curbed by an index-based market-wide "Circuit-breaker" system. Additionally, individual scrip-wise bands of 20 percent can be imposed for all securities except those available for stock options at three stages of index movement, at 10%, 15%, and 20%, as an additional safety measure.

• Trade terminals were allowed to be set up outside of the United States in February 1999 to facilitate market participation by non-residents. In February of 2000, online trading became legal in the United States.

• For the sake of greater market transparency, the Securities and Exchange Board of India (SEBI) outlawed negotiated and cross-dealing in 1991. (Where both the seller and buyer operate through the same broker). Furthermore, private off-market transactions in both shares and publicly listed corporate debts were outlawed entirely. There is no other way for these transactions to be completed.

• Futures trading began in June 2000. NSE and BSE have set up proper trading infrastructure and regularly training programmers in it. With the advent of options trading, the Securities Contracts (Regulation) Act of 1956 was updated. Options contracts based on indexes and stocks were first traded in June and July of 2001, respectively, while stock-based futures contracts were first traded in November of that year.

• Listed companies are required to release their quarterly results. As a result, investors canalways keep an eye on their portfolios. As of November 2001, the practice of disclosing quarterly results has been followed by the stocks-based futures market.

• Publicly traded companies are required to release quarterly financial results. As a result, investors canalways keep an eye on their portfolios. The practice of reporting quarterly results in developed countries is consistent with this practice.

• Imposing a client code and a minimum float for continuous listing to check for price manipulation was passed in November 2001.

• Standardization of stock exchange listing requirements was achieved by the government by amending the Securities Contract (Regulation) Rules, 1957.

• On July 2, 2001, a margin system based on 99 percent value at risk (VaR) was introduced for all scrips in the rolling settlement.

• To raise investor awareness and safeguard their interests, the central government has announced the creation of the Investor Education and Protection Fund (IEPF).

• As of July 2, 2001, all deferral products have been banned, so the restriction on short sales that was announced on March 7, 2001, has been lifted.

• A block deal's full specifics must be made public by all brokers. Over 5% of the equity shares of that publicly traded company are traded in block deals.

• The Securities and Exchange Board of India (SEBI) has allowed corporate brokers with a net worth of at least three crores to extend margin trading facilities to their clients in the cash segment of stock exchanges to increase liquidity in the secondary securities market.

• Shortfalls in settlement can be met by clearing corporations/houses that have been registered with the Securities and Exchange Board of India (SEBI) as an approved intermediary.

• All market participants, including intermediaries, are required by SEBI Regulations, 2003 to apply for an allotment of unique identification numbers for themselves and their associated individuals. The goal of this move is to ensure that all market participants have access to up-to-date information. Investors and companies will have to comply with this later.

• Investor complaints received, disposed of, and unresolved by listed companies should be made mandatory by stock exchanges in clause 41 of the listing agreement.

• On April 1, 2003, the clearing and settlement cycle time was further reduced to T+2.

• The Securities and Exchange Board of India (SEBI) has defined the roles of mutual fund CEOs and fund managers to strengthen their positions, specify accountability, and protect the interests of investors. Both for subscriptions and redemptions, a uniform cut-off time for calculating and applying NAVs was stipulated. Additionally, it stipulated a minimum number of investors for a scheme or plan to be successful.

• Securities and Exchange Board of India allowed mutual funds to invest in derivatives. A maximum of $50 million in foreign securities could be invested in each year, up to a maximum of 10% of the net assets on the 31st of January.

• In June 2003, interest rate futures contracts were introduced, and in August 2003, futures and options contracts on sectoral indices were introduced.

• When an IPO goes public, its international securities identification numbers (ISINs) are activated by depositories only at the time of its initial public offering (IPO) debut.

• Depositories/DPs can't change their policies on BOs who transfer their entire portfolios to another branch of the same depository or a different one, as long as both DPs are the same.

• The delisting was made legal in 2004 under the Securities Contract (Regulation) Act to safeguard the interests of minority shareholders. On October 30, 2006, the Department of Economic Affairs published draught delisting rules that require stock exchanges to delist if they fail to meet certain criteria.

❖ It has lost money for the last three years in a row, and its net worth is now negative.

❖ There has been a six-month suspension in the trading of the securities, or a three-year period of infrequent trading of the securities.

❖ A fine of Rs1 crore or punishment of less than three years is a violation of the SCR Act or SEBI Act of the Depositories Act or the rules and regulations thereunder.

❖ It disappears or provides a false address, or the registered office is changed without authorization.

❖ The public's ownership of the company falls below the bare minimum stipulated in the listing contract.

• All exchange-traded derivative contracts can be invested in by FIIs and NRIs.

• Commodity derivative trading is permitted by stockbrokers.

• ADR/GDR programmers sponsored delisting offers for FIIs, and the government disinvested in publicly traded companies.

• The stock exchanges were allowed to provide a separate trading window for block deals under certain conditions to facilitate the execution of large trades without affecting the market.

• As of November 14, 2005, this window was activated by the BSE and NSE.

Stop to Consider

The financial system's operations, credit distribution, and loan recovery procedure have been politicized, negatively impacting lending quality and loan repayment culture. The extensive write-offs of loans had significantly threatened the institutions' sustainability. The government discouraged the closure of unprofitable industrial units, forcing banks to keep financing them, which in turn affected the banks' own survival.

3.5.3 Government Securities Market Reforms

• A 364-day treasury bill (TB) replaced the 182-day in 1992-1993, and it is being sold fortnightly.

• Auction of 91-day TB commenced from January 1993.\

• The maturity period for new issues of central government securities shortened from 20 to 10 years and that for state government securities from 15 to 10 years.

• Funding of auction TBs into fixed coupon dated securities at the option of holders introduced since April 19, 1993.

- Six new instruments introduced (a) zero coupon bonds on 18.1.94(b) tap stock on 29.7.94, (c) partly paid government stock on 15.11.94 (d) an instrument combining the features of tap and partly paid stocks on 11.9.95. (e) Floating rate bonds on 29.9.95, and (f) capital indexed bonds in 1997.
- State governments and provident funds allowed to participate in 91-day TB auctions on a noncompetitive basis from August 1994.
- A scheme for auction of government securities from RBI's own portfolio as a part of its open market operations was announced in March 1995.
- The institution of Primary dealers in government securities market established and guidelines for then issued in March 1995
- A system of delivery vs Payment (DVP) in subsidiary general ledger (SGL) transactions introduced in Bombay in July 1995
- Reverse Repo facility with RBI in government dated securities extended to discount and finance house of India (DFHI) and securities Trading Corporation of India (STCI)
- Administered interest rates on government securities were replaced by an auction system for price discovery.
- Automatic monetization of fiscal deficit through the issue of Ad hoc treasury bills was phased out.
- Primary dealers (PD) were introduced as market makers in the government securities market.
- For ensuring transparency in the trading of government securities, delivery versus payment (DvP) settlement system was introduced.
- Repurchase agreement (repo) was introduced as a tool of short-term liquidity adjustment.
- Subsequently, the liquidity adjustment facility (LAF) was introduced. LAF operates through repo and reverse repo auctions and provides a corridor for short term interest rates. LAF has emerged as the tool for both liquidity management and signaling device for interest rates in the overnight market. The second LAF (SLAF) was introduced in November 2005.
- MSS has been introduced, which has expanded the instruments available to reserve bank for managing the enduring surplus liquidity in the system.
- Effective April 1, 2006, RBI has withdrawn from participating in primary market auctions of government paper.
- Banks have been permitted to undertake primary dealer business while primary dealers are being allowed to diversify their business.

• Short sales in the government securities is permitted in a calibrated manner while guidelines for when issued market have been issued recently.

• 91- Day Treasury bill was introduced for managing liquidity and benchmarking. Zero coupon bonds, floating rate bonds, capital indexed bonds, were issued and exchanged traded interest rate futures were introduced. OTC interest rate derivatives like IRS/ FRAs were introduced.

• Outright sale of central government dated securities that are not owned have been permitted, subject to the same being covered by outright purchase from the secondary market within the same trading day subject to certain conditions.

• REPO status has been granted to state government securities in order to improve secondary market liquidity.

• FIIs were allowed to invest in government securities subject to certain limits.

• Introduction of automated screen-based trading in government securities through negotiated dealing (NDS). Setting up of risk-free payments and settlement system in government securities through CCIL.

• Phased introduction of real time gross settlement system (RTGS)

• Introduction of trading in government securities on stock exchanges for promoting, retailing in such securities, permitting nonbanks to participate in the repo market.

• Recent measures include introduction of NDS-OM and T+ 1 settlement norms.

• The initiative taken for the development of government security market in the post financial crisis period (2009-2010) were aimed at upgrading the systems, harnessing the development of technology ensure greater transparency, smoothening operating procedure, and deepening the market.

• NDS- Auction (Negotiated Dealing System- Auction) version 2.0 was upgraded to conduct auction for dated securities with effect from 13 may2009.

• H.R Khan Committee (2009) recommended some measures to enhance the efficiency of action procedure, which includes early announcement of the results of action and submission of noncompetitive bids in electronic form.

• For deepening of government securities market, RBI facilitated 'Ready Forward Facility' in dated securities, treasury bills and state development

loans to entities having either Subsidiary General Ledger (SGL) account or Constituent Subsidiary General Ledger (CSGL) account.

• STRIPS (Separate Trading of Registered Interest and Principal of Securities) in government securities was introduced in April 1,2010. The primary objective is to ensure availability of sovereign zero coupon bonds.

• Noncompetitive bidding for state government securities was introduced from the auction held on 25 August 2009.

• The guidelines for SGL transfer were reviewed in the light of the provisions of sections 27 and 30(3) of the Government Securities Act, 2006 and the existing regulatory penalty for SGL bouncing was replaced with a transparent and rule-based pecuniary penalty in July 2010.

• With the stabilization of the transaction and settlement infrastructure, DvP-III (Delivery vs. Payment) facility has been extended in July 2011 to transactions by the gilt account holders (excluding transactions between the gilt account holders of the same custodian) so that gilt account holders get the benefit of efficient use of funds and securities.

• To improve the efficiency of the auction process of G-sec, viz., Government of India dated securities treasury bills (T-bills), cash management bills and state development loans, the timings for primary auction under competitive bidding have been revised from 10.30 am-12.30 pm to 10.30 am -12.30 pm from April 13, 2012. This will permit more time for secondary market transactions for the securities auctioned on that day.

• In 2011, to facilitate direct participation by retail and midsegment investors in G-sec auctions, the Reserve Bank allowed web-based access to the negotiated dealing system (NDS)- auction development by the CCIL.

• The period of short sale was extended from 5 days to 3 months from February 1, 2012. This is expected to give a fillip to the IRF market by helping participants to hedge/arbitrage more effectively, and to develop the term repo market.

Primary and Secondary Stock Market Reforms

• A norm of five shareholders for every Rs 1 lakh of fresh issues of capital and 10 shareholders for every Rs 1 lakh of offer for sale prescribed as an initial and continuing listing requirement.

• The payment of any direct or indirect discounts or commissions to persons receiving firm allotment prohibited.

• Debt issues not accompanied by an equity component permitted to be sold entirely by the book-building process.

• Housing finance companies considered to be registered for issue purposes, provided they are eligible for refinance from the National Housing Bank.

• Issuers are allowed to list debt securities on stock exchanges without their equity being listed.

• MFs permitted to underwrite public issues.

• The stock exchanges are required to disclose, carry forward position scrip-wise and broker-wise at the beginning of carry forward session.

• A ceiling of Rs 10 crores imposed on stock market members doing business of financing carry forward transactions.

• The Depositories Act, 1996 passed to provide a legal framework for the establishment of depositories to record ownership details in book entry form, and to facilitate dematerialisation of securities. The Depositories Related Laws (Amendment), 1997 issued through an ordinance will now allow banks, MFs and IDBI to dematerialise their scrips.

• A stock lending scheme without attracting capital gains introduced. Under this scheme, short sellers can borrow securities through an intermediary before making such sales.

• Stock exchanges asked to modify listing agreements in order to provide for the payment of interest by companies to investors from the 30th day of the closure of public issue.

• All stock exchanges are required to institute the buy-in or auction process.

• Stock exchanges asked to collect 100 percent daily margins on the national loss of a broker for every scrip, to restrict gross traded value to 33.33 times the broker's base minimum capital and to impose quarterly margins based on concentration ratios.

• The stock exchanges are being modernized; many of them have introduced electronic trading systems; the Bombay Stock exchange has started its online trading system, BOLT.

• The Bombay Stock Exchange and other exchanges with screen-based trading system allowed to expand their trading terminals to locations where no stock exchange exists, and to others subject to an understanding with the local stock exchange.

- Both short and long sales are required to be disclosed to the exchange at the end of each day, and they are to be regulated through the imposition of margins.
- There are many other stock market reforms which have been introduced during the past 5 to 6 years. The important ones among them are listed in Chapter 7.
- SEBI framed guidelines relating to disclosure of grading of the initial public offer (IPO) by issuer companies who may want to opt for grading of their IPOs by the ratings agencies. If the issuer companies opt for grading, then they are required to disclose the grades, including the unaccepted ones, in the prospectus.
- SEBI issued directions for the issuing companies, relating to qualified institutions' placement, to pave the path for a fast and cost-effective way of raising resources from Indian securities market.
- To further strengthen Know Your Client (KYC) norms in the cash market and to generate are liable audit trail, PAN was made mandatory for all transactions in the cash market with effect from January 01, 2007.
- 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 nonresident Indians (NRIs). For demat accounts that existed prior to April 1, 2006, time for furnishing and verification of PAN card details was extended upto December 31, 2006.
- Procedure for reintroduction of derivatives contracts and modified position limits were reviewed by the Secondary Market Advisory Committee (SMAC). Further, based on a decision taken by SEBI board, Derivatives Market Review Committee was set up to carry out a comprehensive review of developments and to suggest future directions for derivatives market in India.
- The investment limit for FIIs in government securities (including treasury bills) was raised from UDS 2 billion to USD 2.6 billion by RBI. The list of eligible investment categories of FIIs was enlarged to allow more participation in the Indian securities market.
- SEBI Board approved the draft guidelines for real estate MFs (REMFs). REMF means a scheme of a MF which has investment objective to invest directly or indirectly in real estate property and shall be governed by the provisions and guidelines under SEBI (Mutual Funds) Regulations.

• SEBI introduced a new mode of payment in public issues through book building wherein the application money remains blocked in the bank account of the applicant till allotment is finalized.

• Adoption of International Financial Reporting Standards (IFRS).

• Foreign Institutional Investors (FIIs) permitted to offer Domestic Government Securities as collateral for margins.

• Setting up of a stock exchange/a trading platform by a recognized stock exchange having nationwide trading terminals for Small and Medium Enterprises (SMEs).

• Certification of approved users and sales personnel of the trading members of the currency derivatives segment trading in interest rate derivatives.

• Modification to Investor Protection Fund (IPF)/Customer Protection Fund (CPF) Guidelines.

• Review of Internet-based trading and securities trading using wireless technology.

• In order to facilitate early redressal of investor grievances, SEBI has mandated that stock exchanges having nationwide terminals (such as NSE, BSE, MCX-SX and USEIL), functional stock exchanges having trading volumes, stock exchanges entering into MOU with other exchanges and stock exchanges intending to recommence trading operations shall constitute Investor Grievance Redressal Committees (IGRC) at every investor service center.

• Introduction of liquidity enhancement schemes for illiquid securities in equity derivatives segment.

• Introduction of derivative contracts on Foreign Stock Indices.

• SEBI has mandated the top 100 listed companies to include Business Responsibility Report as part of annual reports with a focus on the environmental, social and governance issues.

3.5.4: Derivatives Market Reforms

• The interest rate futures contract on 10-year notional coupon bearing GOI (Government of India) security was introduced on August 31, 2009.

• Technical Advisory committee (TAC) on the money, foreign exchange and government securities markets proposed to introduce interest rate futures on 5- year and 2 – year notional coupon bearing securities and 91-day treasury bills.

• In 2007, the reserve bank had issued draft guidelines for introduction of credit default swaps (CDS) In India enabling the investors to transfer/ hedge their credit risk.

• In India, centralized reporting of OTC trades in interest rates derivatives [interest rate swaps (IRS)/forward rate agreements (FRAs)] commenced in August 2007 on the reporting platform of CCIL.

• The Currency futures are optional in USD-INR since August 2008. The more currency pairs, viz, Euro-INR, Japanese Yen – INR and Pound Sterling –INR were introduced in the currency futures market during 2009-2010 to provide more avenues to hedge the currency exposure of Indian residents.

• To provide participants with additional instruments to manage volatility in the short- term interest rates, IRF's on 91 –day treasury bills were permitted since March 2011

• In May 2011, CDS on the corporate bond were operationalized and final guidelines were issued in this regard.

• The comprehensive guidelines on OTC foreign exchange derivatives and overseas hedging of commodity price and freight risks were issued in December 2010. The important elements (i)AD (Authorized Dealer) category banks can only offer plain vanilla European cross currency options; (ii) Allowing embedded cross-currency options in case of foreign.

Currency –rupee swaps;(iii) permitting use of cost reduction structures, both under the contracted exposures and past performance routes, subject to certain safeguards; and (iv) allowing swaps to move from rupee liability to FOREX liability, subject to certain safeguards.

The guidelines on 91-day TB IRFs were issued on March7, 2011. Further, the guidelines for cash-settled 2- year and 5-year IRFs were issued in December 2011.

In December 2011, a trade repository –CCIL online reporting engine (CORE) – been set up for reporting CDS trades. Value free- transfer of securities has also been permitted to meet margin requirements.

Check Your Progress

1. Briefly explain the objectives of financial sector reforms
2. Explain the various outcomes of financial sector reforms.
3. Describe the various derivatives market reforms.

3.6 Major outcome of capital market reforms

The following are some major outcome of capital market reforms:

1. Establishment of SEBI: SEBI is the regulatory body of Indian Capital Market which was established in the year 1988. It was assigned statutory power in the year 1992. It was primarily established to perform the merchant bank's activities, to regulate the mutual funds operations, to work like a promoter of stock exchange activities, and serve as a regulatory body over the firms' new offerings. SEBI is the statutory body which is empowered by SEBI Act 1992. It enables the SEBI to implement number of capital market reforms for promoting faith of the investors community. For the regulation of the capital market's healthy and efficient operation, SEBI provides a number of rules and procedures. SEBI has implemented new reforms. It features enhanced disclosure standards and simplified norms issuance procedures.

2. Promotion of mutual funds: Nationalized and Non nationalized banks had given the strength to the mutual funds for undertaking developmental activities to promote growth of the Indian Capital market. These funds have proven beneficial to the public through a tax-savings program. Mutual funds are governed by SEBI and must publish their weekly net asset value in a popular newspaper. Since the worth of the mutual fund investments had fallen below the par value of their existing securities which is quite surprising and worrying situation. We can take an example of the Unit Trust of India (UTI). Its current position is quite worrying which is due to the aforesaid facts.

3. Economic deregulation of Indian capital Market: Many public sector companies in India are exposed to liberalization, privatization, and deregulation due to liberal economic policies. Before privatization, the government did not allow private individuals investment in critical areas. However, during privatization, a limited number of private sectors can participate in public sectors. Few businesses have been privatized at now. ONGC, BHEL, Oil India Ltd., gas authority, etc., are examples of major corporations with shares TATA has acquired through VSNL

4. Promoting more private sectors banks: The establishment of private sector banks has resulted in a substantial profit. The Indian government has proposed a share equivalent to the 74% of the value of equity participation in the public sector. It was proposed to encourage banking system and

open the two existing integrating banks as an example. We can infer the example of ICICI bank which has been amalgamated with Madura bank.

5. Investments from Foreign Institutional Investors :It is widely acknowledged that Foreign Institutional Investors were given offer to start making investment in any Indian Company from existing paid up capital of 5% to 24%. This decision was taken up by the Indian government in the year 1991 when Indian Government was unable to meet the appropriate balance of the foreign exchange as a reserve. It is also observed that participation rate of the foreign institutional investors has positive impact on the inflow of the foreign exchange in the Indian economy.

6. Increase in Foreign Direct Investment (FDI): Since 1991, Indian Economy had witnessed significant growth in the reserve of Foreign Direct Investment. It usually plays an essential role in promoting and developing economic growth of a country. It had also helped the Indian government to curb the unemployment problems. The prominent sectors of Indian Economy like industries, finance, power sector and foreign affairs have witnessed massive growth of Foreign Direct Investment.

8. FERA: Companies Under FERA (foreign exchange regulatory act), foreigners' equity participation is enhanced from 40% to 51% to attract more foreign money to India's capital market. In certain circumstances, companies invest fresh equity without disinvesting their money.

9. National Stock Exchange: Being a prominent and largest stock exchange of India, its head quarter is situated in Mumbai, Maharashtra. National Stock Exchange (NSE) was established in the year1992. It was India's first dematerialized stock exchange. It is the first stock exchange which had introduced fully automated screen based trading system in India. It provides simplest way of trading to investors across the nation.

3.7 Summing Up

The primary focus of financial sector reforms was to establish efficient and stable financial institutions and markets, eliminate structural obstacles, introduce new participants and instruments, implement free pricing of financial assets, ease quantitative restrictions, enhance trading, clearing, and settlement practices, boost institutional infrastructure, refine market microstructure, generate liquidity, depth, and efficient price discovery, and ensure technological advancement.

3.8 Model Questions

1. Discuss the need for financial reforms.
2. Point out the objectives of Financial Reforms
3. Highlight the major reforms in the Capital Market and Primary Market.
4. What are the reforms undertaken in the Government Securities Market.
5. Discuss the recent reforms in the derivative Market
6. Explain the impact of Financial Sector Reforms in India.

3.9 References and Suggested Readings

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Unit-4

Secondary Market- Stock Exchanges, Their Functions, Trading Mechanism

Unit Structure:

4.1 Introduction
4.2 Objectives
4.3 Secondary Markets in India
    4.3.1 Importance of Stock Market
    4.3.2 Role and Functions
4.4 Trading Mechanism in Stock Exchanges
    4.4.1 Traditional Floor Trading
    4.4.2 Modern Electronic Trading System
4.5 Settlement System in the Secondary Market
4.6 Pre-requisite for trading in Stock Exchanges
4.8 Summing Up
4.8 Model Questions
4.10 References and Suggested Readings

4.1 Introduction

A market is a gathering place for buyers and sellers to exchange goods. This is a universal definition that applies to all markets. We will go over the capital market in greater detail in this course. It is a location where various types of capital are exchanged. Individuals like you are frequently the lenders or suppliers of capital. Borrowers and receivers of capital include businesses and other institutions. The market is divided or organized in a variety of ways. The market is divided into two categories: (a) short-term capital market (money market) and (b) long-term capital market (also called stock market). The market can also be classified as (a) Institutional Market and (b) Direct Market.

4.2 Objectives

After going through this unit, you will be able to: -

- understand Secondary Market and Stock Exchanges,
- discuss the importance of the Secondary Market in the financial system.

4.3 Secondary Markets In India

A secondary market is a place where existing securities, like stocks, bonds, options, futures, and so on, are sold and bought. Secondary markets in India are made up of stock exchanges that have been approved by the government and the regulator, like SEBI or the RBI. These exchanges operate under byelaws, rules, and regulations that have been approved by the government and the regulator. The stock exchanges are part of the "organized markets". The securities issued by the Central or State Government, public sector institutions, companies, etc. are traded in the stock market.

Stock exchange is an organized market for the sale and purchase of securities such as shares, stocks, and bonds. In most countries, the stock exchange has two important functions. As a ready market for securities, it ensures their liquidity and thus encourages people to channel savings into corporate investment. As a pricing mechanism, it allocates capital among firms by determining prices that reflect the true investment value of a company's stock.

Indian stock market is one of the oldest and most robust markets among emerging economies. With the rapid improvement in the exchange infrastructure and better investor protection by the market regulator (SEBI), the trade volume is on the rise. Technological advancements such as trading via mobile apps, traders, and trade volume have shot up recently.

The National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) are well-known exchanges in the country. When it comes to global stock exchanges the few names that come to our mind are the New York Stock Exchange, Nasdaq, London Stock Exchange, Tokyo Stock Exchange, Shanghai Stock Exchange, Hong Kong Stock exchange, Euro next, Shenzhen stock exchange, Toronto stock exchange etc.

4.3.1 Importance of Stock Market

The importance of the stock exchange can be studied under the following points:

1. **Formation of capital**: To form the capital for industries, it plays a key role. Though banks and other financial institutions help to form capital the stock exchange is vital for collecting long-term huge capital.

2. **Inspiring savings:** Stock exchanges inspire individuals to reduce current consumption and increase savings. By this means individuals can be benefited and thus the industries as well.
3. **The mobility of resources:** It makes the economy dynamic by helping in the proper mobilization of resources from households to companies. Mobilization of resources is highly required for any country's economic development.
4. **Helping in industrialization:** It helps in industrialization. Stock exchange provides the required capital for the industries. The companies can easily collect the necessary amount of capital by issuing shares or selling debentures in the stock market.
5. **Improving living standards:** It creates attractive investment sectors for the mass people. One can gain easily by investing his savings in the market. Thus, the stock market helps in the improvement of the living standard of general people.
6. **Strong economic base:** It helps industrialization through the mobilization of resources. Thus, it makes the economy strong. For a strong economy, industrial development is essential, and the stock exchange acts here effectively.
7. **Safety of investment:** It secures the investment. The stock exchange maintains rules and regulations to guard the market against fraudulence.
8. **Proper valuation of shares and security:** It has specific rules for the valuation of stocks and securities. It publishes the daily transactionsso that the investors can be aware of the price of shares and securities.
9. **Ready market**: The stock exchange is ready and a secondary market. Like the product and service market, one can buy and sell financial products from and to the stock market. The stock market is almost a financial product-oriented market.
10. **Proper utilization of savings:** Stock exchange helps the proper utilization of savings of general people. It brings the savings and forms capital for the companies, thus utilizing the savings.After all, the stock exchange is an important economic institution. It helps both the investors and the companies for mutual benefits. It deals

with great importance to the development of the economy of a country.

4.3.2 Role and Functions

Stock exchanges play a big role in the consolidation of the national economy. Stock exchange offers a platfrom for trading of securities of the various companies. The various roles played by stock exchanges are discussed as below:

1. Mobilising Surplus Savings**:** The Stock exchanges provide a ready market for various securities. Investors do not have any difficulty in investing their savings by purchasing Shares, bonds, etc. from the exchanges. If this facility is not there then many persons who want to invest their savings will not find avenues to do so. In this way, stock exchanges play an important role in mopping up surplus funds of investors.
2. Promoting Capital Formation:The mobilization of funds from the savers by the capital markets is channelized to various industries that are involved in the production and manufacturing of various goods and services which is beneficial for the economy. This enhances the capital formation and development of national assets. This channelization of savings into appropriate avenues of investment is one of the primary roles of the stock exchanges.
3. Liquidity of Investment**:**As an investor, it is very important to think about how easy it is to get your money out of your investment. This is made possible by the stock exchanges. Investors can sell their stocks and other capital market assets at any time during the trading hours and days. So, stock exchanges make sure that investments can be sold at any time. Following the dematerialization of securities, online trading on the stock exchanges has changed the way people trade. It makes it easier for investors to buy, sell, and move their money.
4. Safety of Investment:One of the most important things that the stock exchange does is make sure that investors' money is safe. Stock trading has been done entirely online since the act of dematerialization took place. The Securities and Exchange Board of India (SEBI) keeps an eye on how the exchanges work and

finds new ways to cheat the system all the time. Measures are taken at times to make sure that investments are safe. The people in charge of the exchanges do their best to stop people from speculating and to make sure that investors don't lose money.

5. Continuous Market for Securities:The stock exchanges provide a ready market for securities. The securities once listed continue to be traded at the exchanges irrespective of the fact that owners go on changing. The exchanges provide a regular market for trading in securities.

6. Helpful in Raising New Capital: The new and existing concerns need capital for their activities. The new concerns raise capital for the first time and existing units increase their capital for expansion and diversification purposes. The shares of new concerns are registered at stock exchanges and existing companies also sell their shares through brokers etc. at exchanges. The exchanges help raise capital throughnew and old concerns. The intending buyers also remain in touch with the exchanges for investing money in securities.

7. Barometer of National Economy: The stock exchanges are the barometer of a nation's economy. The economy of a country is economically symbolized by the most significant stock exchange of that country. These stock exchanges help in representing the progress and situation of a nation's economy at national and international levels. For instance, the Bombay Stock Exchange or BSE is often considered by overseas investors to have an idea about the economic condition of our country.

In sum and substance,the Stock exchange plays a pivotal role in nations' economies. It not only provides a trading platform for borrowers and lenders to exchange their surplus resources but also provides liquidity to shares. Following are some of the most important functions that are performed by the stock exchange:

1. Role of an Economic Barometer: A stock exchange is a solid meter for evaluating economic growth. Every significant change in a country's economy is reflected in stock prices. The rise or decline in stock values shows whether the economy is in a boom or a slump. The stock exchange, commonly known as the economy's pulse or the economic mirror, reflects a country's economic realities.

2. Valuation of Securities: The stock market helps people figure out how much money they need to buy or sell a certain type of thing. Companies that make money and plan are more likely to have their securities valued higher. Valuing securities helps creditors, investors, and the government do their jobs better.

3. Contributor to National Growth: A stock exchange is a place where people can buy and sell stocks from different businesses. This process of trading involves a lot of disinvestment and reinvestment, which allows for more money to be made and for the economy to grow.

4. Transactional Safety: Transactions are safe because the securities that are traded on the stock exchange are listed, and the securities are only listed after the company's position has been checked, which makes sure that the transactions are safe. All the companies that are on this list must follow the rules and regulations that the governing body has set up.

5. Making the public aware of equity investment: Information about investing in equity markets can be found on the stock exchange. They also roll out new issues of securities to get people to invest in them.

6. Offers scope for speculation:To make sure there is enough demand and supply for securities and money, the stock exchange allows healthy speculation about the securities that are traded.

7. Facilitates liquidity:The most important thing the stock exchange does is make sure there is a place for people to buy and sell stocks and other things. This gives investors'confidence that their existing investments can be turned into cash, or in other words, the stock market gives investors the ability to turn their investments into cash.

8. Better Capital Allocation: If a company makes money, its shares will be traded a lot. This means that these companies can get new money from the equity market. To make the most money, the stock market helps investors put their money where they can make the most money.

9. Encourages investment and savings:The stock market is a good place to invest in different types of securities that pay out more money. Investing in the stock market is a better way to make money than investing in gold and silver.

Check Your Progress

1. Why is stock market known as the Economic barometer?
2. Briefly explain the importance of stock market.

4.4 Trading Mechanism in Stock Exchanges

4.4.1 Traditional Floor Trading

The investor places an order for a certain number of shares of a company with his or her broker or sub-broker at the stock market. The broker sends the order to the floor clerk, who then tries to find someone who wants to sell those shares. A lot of bids are made. After the buyer agrees to the price that the seller has set, the deal is done. This method is also called "open outcry," because traders make their bids by yelling them out.

It is used on financial trading floors to communicate buy and sell information in an open outcry trading environment by making hand gestures. The system was used in the Bombay Stock Exchange before there were electronic trading platforms. It is common for traders to flash the signals quickly across a room when they want to make a sale or buy something. Signals that show palms facing out and hands away from the body are a sign that the trader wants to sell. When traders turn their palms in and hold their hands up, they are signaling that they want to buy. The number of fingers shows how many there are. People gesture with one hand the numbers one through five. People gesture with two hands the numbers six through ten (index finger out sideways is six, two fingers are seven, etc.) There are blocks of ten on the forehead, and blocks of hundreds and thousands can also be shown.

In other words, the signals can be used to show months, specific trades, option combinations, or other market information. The rules of each exchange can be very different, but the purpose of the gestures is the same, so the rules don't matter. People who trade stocks electronically can do so much faster and easier than people who trade stocks in person. Online stock market trading is when you place buy and sell orders for stocks in real-time. When the trading system can match bids and a confirmation is sent, the transaction is over.

On regional stock exchanges a few years ago, the open outcry system was very common. Now, there are online screen-based electronic trading systems that make it easier for people to trade. Right from the start, the

NSE and OTCEI used screens to trade. Trades are now done through a computer terminal in the brokers' office. There was a system called "open outcry" in the past. The electronic trading system is better than the open outcry system. It ensures that everyone can see the whole market at the same time. Increases the speed at which price-sensitive information can be added to the prices of things that are already on the market, which makes it easier to find the best prices. Operations are also more efficient because it takes less time, less transaction cost, low risk of error and fraud. This system has allowed a lot of people from all over the country to trade with each other in complete secrecy at the same time, which has made the market wider and more open. People across the country have been able to trade on the same platform because of this. SEBI has given the go-ahead for trading terminals to be set up outside India, as well as for trading on the web. People who want to trade in Indian stocks from any part of the world can now use the Internet to send orders. It costs less to trade on the internet than to use a trading terminal. In India, the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE) let people trade cash electronically.

4.4.2. Modern Electronic Trading System

Floor trading is being replaced by a new system of trading known as screen-based trading in the new electronic stock exchanges, which have a fully automated computerized mode of trading. The trading ring is replaced by a computer screen in this new system, and participants can trade with each other over a computer network. Trading terminals can be installed by member brokers anywhere in the country. A large number of participants, all of whom are geographically separated from one another, can trade at high speeds from their respective locations at the same time. There are two types of screen-based trading systems:

1. Quote driven system.
2. Order-driven system

Under the **quote-driven system**, the market maker, who is a dealer in a particular security, inputs two-way quotes into the system under the quote-driven system, namely his bid price (buying price) and offer price (selling price). Following that, market participants place orders based on the bid-offer quotes. The system then matches these automatically based on certain rules.

Under the **order-driven system**, the brokers are in charge of placing the clients' buy and sell orders. After that, they're fed into the machine. The system matches buy and sell orders based on predefined rules.

Stop to Consider

Some differences between Floor Trading andElectronic Trading

Floor Trading	Electronic Trading
In-floor trading trade used to happen through a broker through an open outcry system	In electronic trading, trade takes place with the help of computers and trade terminals.
The brokerage is usually high	The brokerage is usually low, and it is beneficial for retail investors
In-floor trading settlement takes place usually within 14 working days generally it is T+14	In electronic trading, settlement takes place usually within two working days generally it is T+2

Types of Orders

The most common types of orders are market orders, limit orders, and stop-loss orders.

Market Order:A market order is an immediate purchase or sale of a security. This type of order ensures that the order will be fulfilled, but it does not guarantee the price of fulfillment. A market order will typically execute at or near the current bid (sell order) or ask (buy order) price. Investors should keep in mind, however, that the lasttraded price is not always the price at which a market order will be filled.

Limit Order: A limit order is a purchase or sale of a security at a set price or better. A buy limit order can only be filled if the price is below the limit, and a sell limit order can only be filled if the price is above the limit. An investor, for example, wants to buy shares of ABC stock for no more than Rs. 10. This amount could be specified in a limit order, which will only be executed if the price of ABC stock is Rs. 10 or less.

Stop Order: A stop order A stop-loss order, also known as a loss order, is an order to buy or sell a stock once its price reaches a specified price, known as the stop price. A stop order becomes a market order when the stop price is reached.

A buy stop order is placed at a price that is higher than the current market price. A buy-stop order is typically used by investors to limit a loss or protect a profit on a stock they have sold short. A sell stop order is placed at a price that is lower than the current market price. A sell stop order is typically used by investors to limit a loss or protect a profit on a stock they own.

4.5 Settlement System in Secondary Market

The final stage of the transaction is trade settlement, which is a two-way process. The trade is said to be settled once the buyer receives the securities and the seller receives payment for them. While the transaction date is when the official deal takes place, the settlement date is when the final ownership is transferred. The transaction date is always the same and is denoted by the letter 'T.' The final settlement does not have to take place on the same day as the initial agreement. T+2 is the standard settlement day.

When securities were held in physical form, it took five days to settle a trade after the transaction was completed. After receiving the securities, which came in the form of certificates and were delivered by mail, investors paid with cheque. The delay resulted in price differences, posed risks, and cost a lot of money. Market regulators decided to set a deadline for transactions to be completed to reduce transaction delays. The settlement date used to be T+5 due to paperwork, but it has now been reduced to T+2 following computerization.

Types of settlements in the stock market:

Trade settlements in the stock market have been broadly categorized into two:

1. Spot settlement – This is when the settlement is done immediately following the rolling settlement principle of T+2.

2. Forward settlement – This happens when you agree to settle the trade at a future date which could be T+5 or T+7.

Stop to Consider

Some differences between Spot settlement and Floor Settlement

Spot Settlement	Floor Settlement
A spot rate, or spot price, represents a contracted price for the purchase or sale of a commodity, security, or currency for immediate delivery and payment on the spot date.	A forward contract involves an agreement of terms on the current date with the delivery and payment at a specified future date.
Settled immediately or within 2 to 3 working days usually T+2	Settled at a future date usually T+5 or T+7

Rolling Settlement

A rolling settlement is one in which the settlement is made on each of the trade's subsequent days. Trades are settled in T+2 days in a rolling settlement, which means deals are settled by the second working day. Saturday and Sunday, as well as bank and exchange holidays, are not included. As a result, if a trade is made on Wednesday, it will be settled by Friday. Similarly, if you buy a stock on Friday, your broker deducts the total cost of your investment from your account the same day, but you don't get the shares until Tuesday. The day you become the shareholder of record is also known as the settlement day. For dividend-seeking investors, the settlement day is critical. If the buyer wants to receive a dividend from the company, he must close the trade for a profit before the record date.

Check Your Progress

1. What do you understand by quote driven system?
2. What do you understand by order driven system?
3. What is a Market Order?
4. What is a Limit Order?
5. What is a Stop-Loss Order?
6. Briefly Explain the Difference between Spot Settlement and forward Settlement.
7. What is floor trading and screen based trading?

4.6 Pre-requisite for trading in Stock Exchanges

The practice of engaging in regular buying and selling of shares or stocks is commonly known as share market investment or trading. Before commencing investment activities on the secondary market, it is imperative to adhere to a series of direct procedural guidelines.

- **Step 1:** Open a Demat and trading account.
- **Step 2:** Selection of shares.
    - ➢ The initiation of investment in the secondary market can be regarded as the foundational step. To ensure a smooth transaction, it is advisable to associate both accounts with an existing bank account.
    - ➢ Access your trading account and choose the specific shares you intend to either sell or purchase. It is imperative to verify that the necessary amounts are available in your account to acquire the shares.
- **Step 3:** Select the price point.
- **Step 4:** Complete the transaction.
    - ➢ Determine the desired price at which to execute the purchase or sale of a share. It is advisable to exercise patience until the buyer or seller responds to the request.
    - ➢ Once the transaction is complete, you receive either shares or money for the stocks that you have purchased or sold.
    - ➢ It is important to exercise caution on the length of time you maintain your investment positions and the specific financial objectives you aim to accomplish through your investing activities.
    - ➢ The requisite documentation for initiating the process of opening a Demat/Trading Account

To begin investing in the share market, you need to have the following documents:

- ➢ PAN Card
- ➢ Aadhaar Card

- Name on a canceled cheque from their active bank account showing IFSC Code, account number, Account holder's name, and signature.
- Documents detailing that the applicant earns a steady income.
- A proof of address that is based on a list of documents that have been accepted by your broker, depository participant, or bank.
- Passport-sized photographs of the applicant.

4.7 Summing Up

The secondary market is a place where securities are traded after they have been first offered to the public in the primary market and/or listed on the Stock Exchange. The secondary market is where most of the trading takes place. The equity and debt markets make up the secondary market. The secondary market provides an efficient platform for trading securities for the average investor. Secondary equity markets serve as a monitoring and control conduit for the company's management, facilitating value-enhancing control activities, enabling the implementation of incentive-based management contracts, and aggregating information (via price discovery) that guides management decision-making.

4.8 Model Questions

1. Write brief note on a recent public issue of a company. The note may include the size of the issue, type of security offered, price, and justification of premium, registrar, banker to issue, underwriter, etc.
2. Write out two sources of stock market information other than a newspaper.
3. Discuss the role and importance of secondary market in India.
4. Discuss the trading Mechanism in stock exchanger in India.
5. Elaborate the settlement system in India stock exchanger.
6. What are the pre-requisite for trading in stock market?

4.9 References and Suggested Readings

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Unit-5

Security Depositories and its Benefits-
NSDL and CDSL

Unit Structure:

5.1 Introduction

5.2 Objectives

5.3 Meaning and Concept of Depository

5.4 Functions of Security Depositories

5.5 Parties in a Depository System

5.6 How Security Depository Works

5.7 Current Indian Scenario of depositories

5.8 Summing Up

5.9 Model Questions

5.10 References

5.1 Introduction

In common parlance, a depository can be understood as a place or an arrangement where people can store certain stuff or some important materials. In line with this, the financial system also has the concept of "depository" which serves the basic function of centralized storage and trading of securities. When it comes to any type of asset or property, the ownership can be claimed only through the production of papers, documents; or the certificates to be specific. In simplest sense, depositories can be understood as the institutional arrangement with the help of which documents related to holding and transfer of securities can be stored in a centralized location which can further assist in their trading. The concept of depository has emerged from the loopholes associated with the conventional trading system which required investors to keep the documents in paper form, creating difficulties in handling huge volumes of papers. This also led to increase in costs and inefficiencies. This unit summarizes the concept of depository along with its components, functions and benefits, and the current scenario of depositories in India.

5.2 Objectives

After going through this unit, you will be able to–

- *understand* the meaning and concept of depository,
- *understand* out the functions of a depository,
- *know* the parties involved in a depository system,
- *discuss* how the depository system works,
- *analyse* the current scenario of Indian depository system.

5.3 Meaning and Concept of Depository

Depository means a place or facility where something is stored or deposited for safekeeping. In similar way, in the securities market, a depository refers to an organization which undertakes the task of holding securities of an investor in electronic or "dematerialized" form and also to facilitate transfer of ownership of such securities.

To understand it in a clearer way, first we need to understand the concept of dematerialization of securities. Let us consider a case where we have purchased a property. The only way to claim ownership and identify as the owner of such property will be through the property papers which we have received from the previous owner at the time of purchase. Similarly, when we buy a share, in return we would receive a share certificate. This share certificate is nothing but a document which entitles the holder the ownership of such share in a company. Similarly, in case of other financial securities also, the buyer or the investor receives security certificates. Before 1996, in India these security certificates or securities were in paper format. In 1996, the Securities and Exchange Board of India (SEBI), which is the regulatory authority of the securities market in India, introduced "Dematerialization" of the securities. SEBI made it mandatory to Dematerialization is the process of converting paper certificates or physical certificates of an investor into electronic or digital form. It is often abbreviated as "Demat" form. Now, storing of these security certificates in Demat format can only be done digitally. Like a bank account, the storage place for the dematerialized securities is called the "Demat Account". Here comes the role of the Depository, which is a financial intermediary/ institution that offers demat account services.

Hence, depository may be understood as an organization which holds securities of an investor (like shares, bonds, debentures, government securities, mutual fund units, etc.) in virtual or dematerialized form and also provides transfer services consequent to every trading in such securities.

Stop to Consider

Growth of technology and innovation has blurred the boundaries of financial market by expanding its reach to the global investors. This has changed the financial system in both positive and negative ways. Pointing at the positive ones, there is growth of different financial intermediaries across nations providing diversified financial services, increased efficiencies due to competition, etc.; whereas the negative ones may include lots of paper work resulting from increased volume of trade and so on. Increased participation of different investors also increased the problems associated with huge volume of trade and paperwork. Owning and transferring of different securities and trading in them require lot of paper work which needs to be stored and kept properly. Prior to depository, the work was entirely paper based. This previous system had its own inherent loopholes such as: delay in transfer of shares, possibility of forgery of various documents, possibility of theft of share certificates, loss of share certificates, existence of fake certificates, etc. Presence of these issues were indeed the constraints in making the securities market investor friendly.

5.4 Functions of Security Depositories

The primary role of a depository is to hold securities of investors in digital form in their demat accounts, and also to facilitate transfer subsequent to trading. On execution of trade, i.e., buy or sale, the depository directly transfers the securities from seller's demat account to the buyer's demat account. Apart from this, depositories perform a lot of other functions.

The important functions performed by a depository can be discussed as follows:

1. **Serves as a link between public companies and investors/ shareholders:** The public companies issue various financial securities like shares, debentures, bonds, etc. The investors or shareholders subscribe to such shares or invests in their securities. A depository

serves as the link between both the parties. Depository Participants (DPs), who are the agents associated with the depositories, are responsible for issuance of the securities. The transfer of securities from the depositories to the investors is the responsibility of these DPs.

2. **Secondary Market Services:** In the context of a depository, the secondary market services refer to the activities and facilities provided to investors and market participants for the trading and settlement of previously issued securities. These services enhance the liquidity and efficiency of the secondary market. A depository assists the settlement of trades, i.e., on successful completion of trading, the depository facilitates the electronic transfer of securities between the buyer's and seller's demat accounts. This enables seamless and quick transfer of ownership, reduces settlement risks and ensures timely and secure settlement. A depository also facilitates the transmission of securities in case of changes in ownership due to events like inheritance or legal processes. Depository manages and processes corporate actions such as collection of dividends and interests, bonus issues, rights issues, stock splits, mergers etc. to ensure that shareholders receive their entitlements in a timely and accurate manner. In addition, depository also allows investors to pledge or hypothecate their securities to avail loans or meet margin requirements for trading.

3. **Removes the risk and burden of holding physical securities:** Depository facilitates holding of securities in demat or electronic form. This relieves traders and investors of the burden of holding physical securities. This also eliminates risks related to holding physical securities. The security certificate which signifies the ownership of a particular security, if lost, can cause severe risk and financial loss to the investors. The depository system eliminates such risks associated with physical certificates like bad delivery, fake security, delays, thefts, etc.

4. **Reduces Paper Work and Minimizes Transaction Cost:** Prior to the advent of depository system, securities market workings were entirely paper based. While investing, investors used to receive the physical securities or security certificates and every subsequent trading thereof involved transfer of these physical securities. But now depositories have significantly reduced the paper work associated with trade settlement and have accelerated the process of transfer of securities. Due to this transaction costs related to securities trading have also been minimized significantly.

5. **Provides Material Information:** As an intermediary of public companies and investors, depositories ensure smooth flow of information to both the parties. Depositories continuously intimate investors about their periodic security holdings, any transfer in ownership, corporate actions, and more such material information. On the basis of the information provided by the depositories, companies too can maintain very huge shareholding data accurately, without any error.

6. **Creation of liquidity in the securities market:** Apart from storing securities in demat form, depositories also offer loans or mortgages against such securities held by the investors. This can be utilized by the investors for purchase of other securities. This liquidity (or loan) offered by a depository to its clients (investors) is called as 'margin'.

Stop to Consider

The financial market, especially the capital market has become more disciplined and systematic with the emergence of depository system. This is so due to the inherent benefits associated with the system itself. On many aspects like: time saving in communication, reduction of fraudulent transactions, loss of physical security certificates, theft and forgery, etc. depository system has got its own benefits. Furthermore, a depository system provides benefits to all the constituents of the capital market: the investors, the issuers, the intermediaries and the country as a whole.

5.5 Parties in a Depository System

The depository system represents the institutional framework and includes different participants at different stages/points which help the entire system to function smoothly. The depository system functions through certain constituents. Generally, there are four parties involved:

- The Depository
- Investor or the Beneficial Owner (BO)
- The Depository participants
- The Issuer

The Depository: The Depository is the most important party and is at the center of the complete process. The depository acts like a securities bank, wherein the certificates and documents related to title of ownership for different securities are kept in dematerialized form. Also, it establishes the link between the depository participant, issuer and issuer's agent. The prime cause of its emergence can be pointed as the existence of huge volume of paper work which also causes difficulties in safe-keeping of the same. This cause has led to maintaining the paper or documents in dematerialized or demat form. The depositories provide the process of dematerializing and rematerializing at the time of surrender and withdrawal of securities respectively. As holding securities in physical form had its own disadvantages, depositories enable the investors to hold securities in electronic form. A depository needs to be registered as a depository with SEBI and has to be promoted as a corporate body under Companies Act, 1956. After getting the certificate of commencement of business from SEBI, it can start operating. Currently, there are two depositories in India: NSDL and CDSL.

Investor or the Beneficial Owner (BO): In legal terms, a beneficial owner (BO) means an individual who enjoys ownership benefits of some specific asset even though that particular asset or property and its legal title do not belong to him. The BO in the context of a depository is the investor, who avails the services of the depository. To be a BO the investor has to open a Demat account with a depository with the help of any depository participant for dematerialization of his holdings and transferring securities. These investors get the rights and benefits which imply they will receive bonus, dividends, right to vote, etc. on the shares held by the depository on their behalf. However, the investors will also have liability on such securities, for example the unpaid amount on shares. For availing depository services, the investors need to pay charges to the depository participants. It is to be noted that the same beneficial owner (BO) can open more than one demat account with the same or multiple Depository Participants. In simple, the beneficial owners are like the clients of the depository system who need to follow certain prescribed rules while opening demat account and trading in securities.

Depository participant: As investors cannot walk into National Stock Exchange (NSE) or Bombay Stock Exchange (BSE) office to open a trading account, in similar way investors cannot directly approach a depository for opening a demat account. To open a demat account, one has to approach an intermediary known as a Depository Participant (DP). In simple, a DP is

an agent of the depository for providing depository services. Depository participants are the first point of contact with the investor and they establish a link between the depository and the beneficial owner. Depository participant acts as the representative of an investor in the depository system. As per SEBI, any of the public financial institutions, commercial banks operating in India with the approval of the Reserve Bank of India, state financial corporations, custodians, stock-brokers, clearing corporations / houses, NBFCs and Registrar to an Issue or Share Transfer Agents complying with the requirements prescribed by SEBI can get registered and become a Depository Participant (DP).

The Issuer: The issuer refers to the party who issues the securities which have been submitted to the depository to be kept in dematerialized form. Issuers can be anyone like a company or its registrar and transfer agent (R&T), corporations, investment trusts, mutual fund, or even domestic or foreign government. In simple, issuer is any legal entity that is permitted to develop, register, and sell securities to raise capital and finance its operations, expansion, or other strategic initiatives. These securities can take various forms, such as stocks, bonds, mutual fund units, government bonds or other financial instruments.

In a depository system, after an IPO or subsequent issuances, issuing companies work closely with depositories to credit the demat accounts of investors with the newly issued securities. These securities exist in electronic or dematerialized form within the depository, making the transfer and ownership process more efficient and secure.

Stop to Consider

Depository can be understood as a financial institution which acts as a custodian of security certificates. Due to the inherent limitations of traditional paper-based trading system, investors and other parties to trading could not get the maximum benefit. As a result of this, the concept of depositories emerged. The system of depository is a combination of certain elements or constituents: depository participants, investor, issuing company and the depository itself.

Check Your Progress

1. What is meant by Depository?
2. What is depository system?
3. What are the functions or benefits of Depository System?
4. What are the major constituents of a depository system?

5.6 How Security Depository Works

Having understood the meaning and concept of depository and depository system, it is necessary to knowhow security depositories function. As have been discussed in the previous section, there are four parties in a depository system: the beneficial owner (BO), the depository participant (DP), the depository, and the issuer or its registrar and transfer agent (R&T). All of them are interconnected in the depository process. A general overview of how a security depository process works can be discussed as below:

A. Opening of a Demat Account: The depository system operates and functions through depository accounts (or demat accounts) of the investors (beneficial owners) which are somewhat similar to opening of bank accounts. Opening depository account is the basic step to be followed by every investor who is willing to dematerialize holdings. Investors who want to avail the depository services have to open a Beneficial Owner Account, most commonly known as a Demat Account, with a depository through a DP. DPs are typically any financial institution registered with the depository who acts as an agent. The investor has to fill up and submit account opening form along with necessary documents (like identity proof, photograph, PAN card details, KYC etc.) to the DP. Through this the investor enters into an agreement with the DP, and after verification and payment of required fee the investor will be issued a Client Account Number or Client ID Number.

B. Initiating Dematerialization: Investors who hold physical share certificates can choose to convert them into electronic form by initiating the dematerialization process. It involves the following stages:

1. Submission of Request with Depository Participant: For converting physical certificates to dematerialized form the investor will have to make an application with the DP through a request form known as Dematerialization Request Form (DRF). The investor also needs to surrender the physical share certificates they wish to dematerialize to the DP.

2. Forwarding of DRF: After receiving a DRF, the DP electronically registers the request with the Depository through the system. DP also forwards the DRF along with the security certificates to the issuer or issuer's registrar and transfer agent within seven days of its receipt. The Depository too electronically forwards the demat request to the issuer or issuer's registrar and transfer agent for verification.

3. Verification and Authentication: The issuer of the security or its registrar and transfer agent (R&T)verifies the authenticity of the physical certificates and the investor. It scrutinizes the validity of the security certificates and makes sure that the investor making the demat request is an authentic holder of such security.

4. Crediting of Investor's Demat Account: Once verified, the issuer or its R&T authorizes the Depository electronic credit for the security in favour of the investor. Depository then credits the investor's Demat account with an equivalent quantity of electronic securities and informs it to the DP. Finally, the DP updates the demat account of the investor.

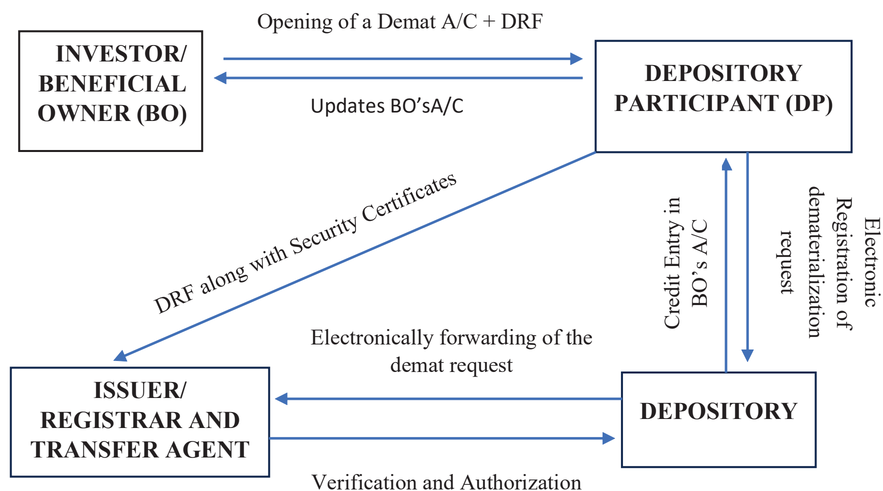

Fig: The Working Process of a Depository

Stop to Consider
Dematerialization and rematerialization are two significant processes followed in depository system. The process of rematerialization is exactly opposite of dematerialization and is concerned with converting the electronic holdings into paper certificates. Just like dematerialization, rematerialization is also carried out in a similar way through depository

participants. Therefore, in the depository system, an investor can dematerialize her/his holdings into electronic form and again can convert the same into physical securities whenever needed. When the investor requests for rematerialization, the depository participant intimates the request through the system and confirms the process to the issuer or its registrar and transfer agent. Subsequently, the depository participant debits the investor's demat account. The registrar and the depository also update the accounts and other details, following which the share certificates are dispatched to the concerned investor.

5.7 Current Indian Scenario of Depositories

The Depositories Act, 1996 prescribes different provisions and rules which act as guidelines for the depositories operating in India. Some such provisions include: all securities held by a depository should be in fungible form, the depository should be registered owner of the securities for the purpose of effecting transfer of ownership on behalf of the investor or beneficial owner, furnishing information to beneficial owner and issuers whenever necessary, etc. The year 1996 has been a significant year in the history of financial market in India. During the period, physical trading in securities was prevalent and the Government of India introduced the Depository Bill in Lok Sabha in 1996 to bring scrip-less trading in securities with a view to avoid bad delivery, theft, forgery, etc. India has currently the two depositories: NSDL and CDSL. The following section briefly explains about the two

NSDL: National Securities Depositories Ltd has been promoted by Industrial Development Bank of India, Unit Trust of India and National Stock Exchange and it has emerged as the first depository to be registered in India. It is one of the largest depositories in the world and was established in the year 1996. The enactment of Depositories Act in August, 1996 paved the way for establishment of NSDL. In its system, securities are held in depository accounts, which is somewhat similar to keeping funds in bank accounts. Transferring the ownership of securities is done through account transfers, which keeps away the risk and difficulties associated with traditional paper-based system of trading in securities. NSDL also offers bundle of services to different parties like: investors, stock brokers, custodians, issuing companies, etc. through its nationwide network of depository partners. Apart from this, it also provides stock lending and borrowing facilities to the investors subject to the rules and regulations

applicable. Moreover, there is also facility through which the investor can receive his/her corporate benefits through NSDL. Here, the registrar is responsible for disbursement of cash benefits from dividends, interest etc., whereas the depository will distribute the securities entitlement on the basis of the information received from the registrar. NSDL operates through depository participants to perform the functions like: getting withdrawal and surrender of securities from and to the depository, maintaining investors' holdings in electronic form, conducting settlement of securities traded on and off the stock market, etc. As on 2022, NSDL has a total of 276 DPs, has Demat custody value (Lakh Crore) 290.72 and 2,60,69,206 active investors account.

CDSL: Central Depository Services Ltd was established in the year 1999 with the objective of providing convenient, dependable and secured depository services. Similar to NSDL, CDSL is a crucial part of the capital market and it provides services to different participants like: stock exchanges, depository participants, issuers, investors, etc. CDSL received its certificate of commencement of business from SEBI on February 8, 1999. It enables dematerialization and rematerialization of securities so as to meet the objectives of providing the stakeholders quality service. At present there are 584 DPs and 6,07,62,732 investors account with CDSL.

Check Your Progress

1. What is meant by dematerialization of securities?
2. Discuss the process of dematerialization of securities.
3. What are the two depositories operating in India?
4. Why do you think depositories have assumed importance in the Indian financial system?
5. Do you think introduction of depository system has really made the securities market more efficient and investor friendly?

5.8 Summing Up

- The concept of depository has emerged from the loopholes associated with the conventional trading system which required investors to keep the documents in paper form, creating difficulties in handling huge volumes of papers.

- Depository may be understood as an institutional arrangement which holds securities in "dematerialized" form, wherein trading is done among different securities like shares, debentures, mutual funds, etc.
- The depository system functions through certain constituents as mentioned below:

  Depository

  Investor or Beneficial Owner (BO)

  Depository participants

  Issuer of Securities/Registrars and Transfer Agents
- Dematerialisation' is a process where by physical existence of security certificates is made extinct and converted into electronic holdings.
- Rematerialisation is a process of converting electronic holdings of investor back into share certificates in paper form.
- In India, currently there are two depositories: NSDL and CDSL.

5.9 Model Questions

Q1. What is a depository?

Q2. What are the benefits of depository?

Q3. Who are the main parties involved in a depository system?

Q4. What is depository system? How does it work?

Q5. What do you mean by Dematerialization of securities?

Q6. What are the advantages associated with dematerialization of securities?

Q7. What is rematerialization of securities?

5.10 References and Suggested Readings

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