[Academic Script]

Secondary Market in India Part - 2

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Unit No. & Title:	Unit – 3 Secondary Market in India
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Academic Script

1. Trading on a stock exchange

In this session we are going to discuss the trading on a stock exchange.

The first step of trading is selecting a Broker/Sub–Broker

It is essential to deal only with a SEBI registered Broker/Sub-broker after due diligence. Details of the BSE/NSE Brokers can be obtained from the Member's List published by BSE/NSE and from their website.

The next step is to entering into an Agreement with registered Broker or Sub–broker.

Fill in a Client registration form with the Broker/Sub–broker.

Enter into Broker/Sub-broker - Client Agreement. This agreement is mandatory for all investors for registering as a client of a BSE Trading Member. Ensure the following before entering into an agreement.

Carefully read and understand the terms and conditions of the agreement before executing the same on a valid stamp paper of the requisite value Agreement to be signed on all the pages by the Client and the Member or their representative who has the authority to sign the agreement. Agreement has also to be signed by the witnesses by giving their names and addresses. Please note that Regulatory Authorities have not stipulated for execution of any document other than Broker/Sub-Broker - Client Agreement.

Now for Transacting

Specify to the Broker/Sub-broker, the exchange through which your trade is to be executed and maintain separate account for each exchange.

Obtain a valid Contract Note from the Broker/Sub-broker within 24 hours of the execution of the trade. Contract note is a confirmation of trade(s) done on a particular day for and on behalf of a client in a format prescribed by BSE. It establishes a legally enforceable relationship between the Trading Member and his Client in respect of settlement of trades executed on BSE as stated in the Contract Note. Contract Notes are made in duplicate, and the Trading Member and Client, both keep one copy each. The Client is expected to sign on the duplicate copy of the Contract Note, confirming receipt of the original.

1. Contract Note - Form 'A' - Contract Note issued where Member is acting for constituents as brokers/ agents.
2. Contract Note - Form 'B' - Contract Note issued by Members dealing with constituents as principals.

Ensure that the Contract Note contains: SEBI registration number of the Trading Member/Sub–broker Details of trade such as, Order no., trade no., trade time, quantity, price, brokerage, settlement number, details of other levies.

Trade price should be shown separately from the brokerage charged. The maximum brokerage that can be charged is Rs.0.25 per share/debenture or 2.5% of the contract price per share/debenture whichever is higher. This maximum brokerage is inclusive of the brokerage charged by the sub-broker (Sub-brokerage cannot exceed 1.5% of the contract price.) Any additional charges that a Trading Member can charge are Service Tax on the brokerage, any penalties arising on behalf of client and Securities Transaction Tax (STT). The brokerage, service tax and STT are required to be indicated separately in the Contract Note.

Signature of authorized representative

Arbitration clause stating that the Courts in Mumbai shall have exclusive jurisdiction in respect of all proceedings to which the Exchange is a party, and in respect of all other proceedings, the Courts having jurisdiction over the area in which the respective Regional Investor Service Centre is situated, shall have jurisdiction, must be present on the face of the Contract note.

Settlement

Ensure delivery of securities/payment of money to the broker immediately upon getting the Contract Note for sale/purchase but in any case, before the prescribed pay-in-day.

Member should pay the money or securities to the investor within 24 hours of the payout.

2. Open a Demat account

Traditionally, settlement system on Indian stock exchanges gives rise to settlement risk due to time that elapses before trades are settled. Trades were settled by physical movement of certificates. The time consumed was very high, also expensive and chances of bad delivery may happen.

In order to streamline these problems the Dematerialization – conversion of physical shares to electronic form was introduced.

For this purpose 2 depositories were developed –

NSDL (National Securities Depository Limited) and CDSL (Central Depositories Services (India) Limited)

Now, continuing the above process an Investor should Opt for buying and selling shares in demat form.

For delivery of shares from demat account, give the Depository Participant (DP) 'Delivery out' instructions to transfer the same from the beneficiary account to the pool account of broker through whom shares and securities have been sold. The following details to be given to the DP: details of the pool a/c of broker to which the shares are to be transferred, details of Security, quantity etc. As per the requirement of depositories the 'Delivery out' Instruction should be given atleast 48 hours prior to the cut-off time for the prescribed securities pay-in.

For receiving shares in your demat account, give the Depository Participant (DP) 'Delivery in' instructions to accept shares in beneficiary account from the pool account of broker through whom shares have been purchased.

If physical deliveries are received check the deliveries received as per Good/Bad delivery guidelines issued by SEBI.

3. Margins

In order to contain the risk arising out of transactions entered into by the members in various Securities either on their own account or on behalf of their clients, BSE has a well designed risk-management system which inter-alia, includes collection of margins from the Members. BSE accordingly imposes various kinds of margins on the Members based on their outstanding positions in the market.

Computation of Margins

For securities that have been listed for less than six months, the trading frequency and the impact cost is computed using the entire trading history of the Security.

VaR Margin

As mandated by SEBI, the Value at Risk (VaR) margining system, which is internationally accepted as the best margining system, is applicable on the outstanding positions of the Members in all Securities.

The VaR Margin is a margin intended to cover the largest loss that can be encountered on 99% of the days (99% Value at Risk). For liquid stocks, the margin covers one-day losses while for illiquid stocks, it covers three-day losses so as to allow the Exchange to liquidate the position over three days. This leads to a scaling factor of square root of three for illiquid stocks.

For liquid stocks, the VaR margins are based only on the volatility of the stock while for other stocks, the volatility of the market index is also used in the computation. Computation of the VaR margin requires the following definitions.

Security sigma means the volatility of the security computed as at the end of the previous trading day. The computation uses the exponentially weighted moving average method applied to daily returns in the same manner as in the derivatives market.

Security VaR means the higher of 7.5% or 3.5 Security sigma.

Index sigma means the daily volatility of the market index (S&P BSE Sensex or CNX Nifty) computed as at the end of the previous trading day. The computation uses the exponentially weighted moving average method applied to daily returns in the same manner as in the derivatives market.

Index VaRmeans the higher of 5% or 3 index sigma. The higher of the Sensex VaR or Nifty VaR would be used for this purpose.

Collection of VaR Margin

- The VaR margin is collected on an upfront basis by adjusting against the total liquid assets of the Member at the time of trade.
- The VaR margin is collected on the gross open position of the Member. The gross open position for this purpose is the gross of all net positions across all the clients of a Member including his proprietary position.
- For this purpose, there would be no netting of positions across different settlements.
- Dissemination of Information :

The VaR amount applicable in respect of the Securities is disseminated on the BSE website on a daily basis.

Extreme Loss Margin (ELM)

The term Extreme Loss Margin replaces the terms "exposure limits" and "second line of defense" that have been used hitherto. It covers the expected loss in situations that go beyond those envisaged in the 99% value at risk estimates used in the VaR margin.

- The Extreme Loss Margin for any stock is higher of:
  5%, and 1.5 times the standard deviation of daily logarithmic returns of the stock price in the last six months. This computation is done at the end of each month by taking the price data on a rolling basis for the past six months and the resulting value is applicable for the next month.

- The Extreme Loss Margin is collected/adjusted against the total liquid assets of the member on a real time basis.
- The Extreme Loss Margin is collected on the gross open position of the Member. The gross open position for this purpose means the gross of all net positions across all the clients of a member including his proprietary position.
- For this purpose, there is no netting of positions across different settlements.
- The Extreme Loss margin so collected is released along with the pay-in.
- Dissemination of Information:
  The ELM amount applicable in respect of the Securities is also disseminated on the BSE website.

Special Margin

Special margin may be imposed by BSE from time to time on certain Securities as a surveillance measure and informed to the Members through notices.

Mark-to-Market Margin (MTM)

The MTM margin is collected on the gross open position of the Member. The gross open position for this purpose would mean the gross of all net positions across all the clients of a member including his proprietary position. For this purpose, the position of a client is netted across his various securities and the positions of all the clients of a Member are grossed. Further, there is no netting across two different settlements.

There is no netting off the positions and setoff against MTM profits across 2 rolling settlements i.e. T day and T-1 day.

However, for computation of MTM profits/losses for the day, netting or setoff against MTM profits is permitted.

Kinds of brokers

The main player in secondary market are the brokers. They may act in different capacities – as a principal, as an agent, as a speculator and so on. Hence, brokers may be classified as Jobbers, commission brokers, sub-brokers, authorized clerk. All these brokers either act themselves or on behalf of and help in creating volume in the market.

4. Compulsory Rolling Settlement

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

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

The transactions in securities of companies which have made arrangements for dematerialization of their securities are settled only in demate mode on T+2 on net basis, i.e., buy and sell positions of a member-broker in the same Security are netted and the net quantity and value is required to be settled.

However, transactions in securities of companies, which are in "Z" group or have been placed under "trade-to-trade" by BSE as a surveillance measure ("T" group), are settled only on a gross basis and the facility of netting of buy and sell transactions in such Securities is not available.

In case of Rolling Settlements, pay-in and pay-out of both funds and securities is completed on the same day.
Members are required to make payment for securities sold and/ or deliver securities purchased to their clients within one working day (excluding Saturday, Sunday, bank & BSE trading holidays) after the pay-out of the funds and securities for the concerned settlement is completed by BSE. This is the timeframe permitted to the Members to settle their funds/ securities obligations with their clients as per the Byelaws of BSE.

5. Summary

With the advancement in the technology the trading in Secondary market has become easier as compared to the traditional methodology. Earlier the investors were supposed to go to the stock exchange for every task they perform. But now SBTS and WAP had made it easier to trade and also to transfer different types of margin money with the help of Internet banking facility. The prospective buyer and seller can trade online from anywhere in the world. The secondary market has facilitated to create market transparent and a better capital market in the country.