UNIT 8 STRUCTURE OF FINANCIAL MARKETS

Structure

8.0 OBJECTIVES

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

- get a view of the institutional structure of the financial markets;
- get acquainted with major stakeholders in primary market; and
- develop awareness about different constituents of the secondary market.

8.1 INTRODUCTION

Financial markets are the centres or arrangements that provide facilities for buying and selling out financial claims and services. The participants on the demand and supply sides of these markets are financial institutions, agents, brokers, dealers, borrowers, lenders, savers, and others. Who are inter-linked by the laws, contracts, covenants and communication networks?

The main organised markets in India are the money market and capital market. While the primary market deals in new issues, the secondary market is meant for trading in outstanding or existing securities. There are two components of the secondary market: Over the counter (OTC) market and the Exchange traded market. The government securities market is an OTC market. In an OTC market, spot trades are negotiated and traded for immediate delivery and payment while in the exchange trade market, trading takes place over a trading cycle in stock exchanges.

8.2 INSTITUTIONAL STRUCTURE OF FINANCIAL MARKETS

As stated above, financial markets are classified as (i) primary markets and (ii) secondary markets. Primary market is also known as a *direct* market, whereas a secondary market is called an *indirect* market. The primary market deals in the new financial claims or new securities deals in the new financial claims or new securities and, therefore, they are also known as the *new issues markets*. On the other hand, secondary markets deal in securities already issued or existing or outstanding. The primary markets mobilise savings and they supply fresh or additional capital to business units. Although secondary markets do not contribute directly to the supply of additional capital, they do so indirectly by rendering securities issues on the primary markets liquid. Stock markets have both the primary and secondary market segments.

The institutional structure of the primary markets differs form that of the secondary markets. Let us have a look on each of these:

8.3 PRIMARY MARKET STRCUTURE

The primary market is a market for new issues. It is a market for fresh capital. Funds are mobilised in the primary market through (i) prospectus, (ii) rights issues, and (iii) private placement. Bonus issues is also one of the ways to raise capital but it does not bring in fresh capital.

i) In the **prospectus** route, new issues of capital are offered to the public through prospectus and the public subscribes directly. Wide publicity about the offer is given through the media.

ii) **Rights issue** is the issue of new shares in which existing shareholders give pre-emptive rights to subscribe to the new issues on a pro-rata basis. The right is given in the form of an offer to existing shareholders to subscribe to a proportionate number of fresh, extra shares at a price. Companies issue right shares by sending a letter of offer to the shareholders whose names are recorded in the books on a particular date. A shareholder has four options in case of rights (a) he may exercise his rights, i.e., buy new shares of the offered price (b) renounce his rights and sell them in the open market (c) renounce part of his rights and exercise the remainder and (d) choose to do nothing.

iii) The direct sale of securities by a company to some select people or to institutional investors is called **private placement**. No prospectus is issue in private place. Private placement covers equity shares, preference shares, and debentures. It offers excess to capital more quality than the public issue and is quite inexpensive on account of the absence of various issue expenses.

iv) At times, companies distribute profits to existing shareholders by way of fully paid **bonus shares** instead of paying them a dividend. Bonus shares are issued in the ratio of the existing shares held. The shareholders do not have to pay for bonus shares but the retained earnings are converted into capital. Thus, bonus shares enable a company to restructure its capital.

There are three categories of participants in the primary market. They are the issuers of securities, investors in securities, and the participants. The last render services to both the issuers and investors to enable the sale and purchase of securities. The lead merchant banker performs most of the pre-issue and post-issue activities. The pre-issue activities relate to drafting, examining and issuing of prospectus, application forms, advertisement, and so on. Post-issue activities relate to the allotment, refund and dispatch of certificates. The Securities and Exchange Board of India (SEBI) regulates the primary market.

8.3.1 Securities and Exchange Board of India (SEBI)

The Securities and Exchange Board of India (SEBI) was established through notification on April 12, 1988 to keep pace with the growing requirement of curbing unhealthy practices in fast expanding securities market and to protect interest of investors. The SEBI Act was passed on April 4, 1992, which empowered SEBI to regulate entire gamut of activities in primary and secondary markets. SEBI exercises control over new issues registration and regulation of market intermediaries, regulation of mutual funds, regulating listing of securities, imposing a code of conduct on merchant bankers, underwriters, brokers, etc., prohibition of unfair trade practices, and insider trading, regulation of take-overs, etc. SEBI also makes an attempt to establish and promote self-regulatory organisations in securities market and ensure that stock exchanges discharge their self-regulatory role with efficiency and integrity.

The Preamble of the SEBI Act provides for the establishment of a Board to protect the interests of investors in securities and to promote the development of and to regulate the securities market. The following functions have been entrusted to the Board:

i) Regulating the business in stock exchanges and any other securities markets;

ii) Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

iii) Registering and regulating the working of collective investment schemes including mutual funds;

iv) Promoting and regulating self-regulatory organisations;

v) Prohibiting fraudulent and unfair trade practices relating to securities market;

vi) Promoting investors' education and training of intermediaries of securities market;

vii) Prohibiting insider trading in securities;

viii) Regulating substantial acquisition of shares and take-over of companies;

ix) Calling for information from, undertaking inspection, conducting inquires and audits of the stock exchanges and intermediaries and self-regulatory organisations in the securities market;

x) Levying fees or other chares for carrying out the above purposes; and

xi) Conducting research for the above purposes.

In accomplishing the above objectives SEBI is expected to be responsive to the needs of the following major groups:

a) Investors;

b) The Companies raising capital;

c) Primary market intermediaries; and

d) Stock market brokers and intermediaries.

SEBI exercises powers under Section 11 and 11B of SEBI Act, 1992 and other regulations.

These empower SEBI to:

- Ask any intermediary or market participant for information.
- Inspect books of depository participants, issuers or beneficiary owners.
- Suspend or cancel a certificate of registration granted to a depository participant or issuer.
- Request the RBI to inspect books of a banker to an issue, and suspend or cancel the registration of the banker to an issue.
- Suspend or cancel registration issued to foreign institutional investors.
- Investigate and inspect books of accounts and records of insiders.
- Investigate an acquirer, a seller, or merchant banker for violent takeover rules.
- Suspend or cancel the registration or a merchant banker.
- Investigate the affairs of mutual funds, their trustees, and asset management companies.
- Investigate any person dealing in securities on complaint of contravention of trading regulation.
- Suspend or cancel the registration of errant portfolio mangers.
- Cancel the certificate of registrars and share transfer agents.
- Cancel the certification of brokers who fail to furnish information of transactions in securities or who furnish false information.

SEBI's market surveillance essentially focuses on:

i) Policy formulation for introduction of surveillance systems at the stock exchanges to bring integrity, safety and stability in the Indian securities markets;

ii) Overseeing the surveillance activities of the stock exchanges including the monitoring of market movements by them;

iii) Inspection of the surveillance cells of the sock exchanges;

iv) Preparation of reports and studies on market movements, which SEBI circulates periodically to the Government of India and to securities markets regulators from other countries;

The primary responsibility of market surveillance has been entrusted to the stock exchanges. However, SEBI keeps a proactive oversight on market monitoring and in exceptional circumstances it analyses the same.

Assessment: SEBI, no doubt, acts as a powerful regulator in the securities markets. But, nevertheless, some serious shortcomings in its functioning and operations have been point out. Among these, the more important are as follows:

One,_ on reading the rules, regulations, guidelines, directions and norms issued by the SEBI, one doubts whether one is living in the 'liberalised' or 'prudential' regulation as opposed to 'statistic control' environment at all. It is difficult to believe that 'self-regulation' and 'regulation by exception' is really the cornerstones of the SEBI's regulatory philosophy. The number of rules, etc: prescribed by SEBI has become too large; it has been adding to, and changing them too often and in a back and forth fashion. This has created a veritable maze of a plethora of regulations. This has led to a very high level of uncertainty and confusion.

Two, there is a widespread perception in the financial markets that SEBI is not really desirous about reforming the system and protecting the individual and small investors. It has quite often failed to penalise the people responsible for causing abnormal price fluctuations on the stock market. There has been a lack of will, dithering and hesitancy on the part of SEBI to strike against the wrong doers. Even certain well-publicised market manipulations have gone unpunished.

Three, the regulatory ineffectiveness of the SEBI in certain cases has been due to its concentration on symptoms rather than the root causes. The SEBI failure appears to be partly deliberate also. There is a feeling among market watchers that, as in many other countries, the SEBI as a regulatory has been rather soft and unduly favourable to the securities industry; it has been more corporate friendly than investor friendly.

Four, it is imperative that SEBI should become more effective, efficient, socially accountable, and small-investor friendly. It has often complained of having insufficient authority. The SEBI ought to be made a truly autonomous regulatory authority which it is not at present.

8.3.2 Primary Market Intermediaries

The principal intermediaries in the primary markets are merchant bankers / lead managers, underwriters, bankers to the issue, brokers to the issue, registrars and share transfer agents, and debenture trustees.

A) **Merchant Bankers**

The lead merchant banker performs most of the pre-issue and post-issue activities. Their importance is reflected in the major services/functions such as, determining the composition of the capital structure (type of securities to be issued), draft of prospectus (offer documents) and application forms, compliance with procedural formalities, appointment of registrars to deal with the share application and transfers, listing of securities, arrangement of underwriting / sub-underwriting, placing of issues, publicity and advertising agents printers, and so on. In view of the overwhelming importance of the merchant-bankers in the process of capital issues, it is now mandatory that all public issues should be managed by member banker(s) functioning as the lead manager(s).

Responsibilities/Obligations of Merchant Bankers

A merchant banker has the following responsibilities:

- Enter into a contract with the issuing company clearly specifying their mutual rights, obligations and liabilities relating to the issue, particularly relating to disclosures, allotment and refund.
- Submit a copy of the above contract to SEBI at least one month before the opening of the issue for subscription. In case of more than one merchant banker, simultaneously submit a statement detailing their respective responsibilities.
- Refuse acceptance of appointment as merchant banker, if the issuing company is an associate.

- Do not associate with a merchant banker who does not hold SEBI registration certificate.
- Accept a minimum underwriting obligation of 5 per cent of total underwriting commitment or Rs. 25 lakh, whichever is less, or a range for underwriting of an equal amount by a merchant banker associated with the issue and intimate the same to SEBI.
- Submit the 'Due Diligence Certificate' to SEBI at least two weeks before the opening of the issue for subscription after verification of the contents of the prospectus/letter of offer regarding the issue and reasonableness of the views expressed therein certifying that (i) they are in conformity with the documents, materials and papers relevant to the issue (ii) all legal requirements relating to the issue have been fully complied with, and (iii) al disclosures are true, fair and adequate to enable to investing public to make a well-informed decision regarding investment in the proposed issue.
- Submit to SEBI various document such as, particulars of the issue, draft prospectus/letter of offer and other literature to be circulated to the investors/ shareholders, etc., at least, two weeks before the date of filing them with the registrar of companies and regional stock exchanges.
- Ensure that modifications and suggestions made by SEBI regarding above documents have been incorporated.
- Continue to remain fully associated with the issue till the subscribers have received share/debenture certificates or the refund of the excess application money
- Not to acquire securities at any company on the basis of unpublished price sensitive information obtained in the course of discharge of any client or any other person.
- Submit complete particulars with SEBI within 15 days of the acquisition of securities of the company whose issue the merchant banker is managing.
- Disclose to SEBI following: (i) its r responsibilities regarding the management of the issue (ii) any change in the information/particulars previously furnished with SEBI having bearing on certificate of registration granted to it, (iii) details relating to the breach of capital adequacy norms, (iv) names and addresses of the companies whose issues it has managed or has been associated with, and (v) information regarding its activities as manager, underwriter, consultant or adviser to the issue.

Each merchant banker has to abide by the provisions of the SEBI Act and the rules and regulations framed by SEBI relating to its activities, both in the form of do's and don'ts.

A merchant banker who fails to comply with any condition subject to which the certificate of registration has been granted by the SEBI and/or contravenes any of the provisions of the SEBI Act, rules and regulations, is liable to any of the two penalties (a) suspension of registration, or (b) cancellation of registration. A merchant banker cannot carry on any activity as merchant banker with effect from the date of suspension or cancellation, till registration is restored by the SEBI.

B) **Underwriters**

Another important intermediary in the new issue market is the underwriter

An underwriters make a commitment to get the underwritten issue subscribed either by others or by themselves. They agree to take up the unsubscribed portion of the issue. They render this service for a commission agreed upon between the issuing company and the underwriter subject of the ceiling under the companies Act.

Underwriting services are available from brokers, investment companies, commercial banks and term lending institutions.

Underwriters are appointed by the issuing company in consultation with the merchant bankers/land managers. They have to satisfy that in their opinion, the underwriters' assets adequate to meet their obligations. A statement to this effect is also to be incorporated in the prospectus.

Only such person (an individual, firm or a company) who has obtained certificate of registration from SEBI, can act as underwriter. Merchant bankers and stock brokers already having a valid certificate of registration from SEBI do not require a separate registration from SEBI for working as underwriters.

Various operational guidelines/institutions relating to underwriting to be followed by underwriters can be briefly stated as follows:

- An underwriter has to comply with all requirements regarding registration with SEBI, agreement with the client company and general responsibilities.
- Before signing underwriting agreement with the issuing company, the underwriter should satisfy himself that all terms and conditions regarding disclosure in the prospectus and its filing with Registrar of Certificates have been complied with.
- Ensure that the prospectus is delivered to ROC within 30 days of the underwriting agreement or within such an extended time as approved by the underwriter in writing, subject to the limits within the law.
- In case after filing the prospectus with ROC the issuing company makes any additional disclosure in the interest of investors as stipulated by SEBI / lead managers, the underwriter is bound to comply with them.
- Additional disclosures cannot give any right to underwriter to avoid or reduce his obligations, unless certified by SEBI as material in nature and essential for underwriting agreement.
- An underwriter can arrange for sub-underwriting but he is not responsible for any failure or default on the part of such underwriters.
- An underwriter has to fulfil his obligation regarding devolved amount in case of under-subscription within 30 days of the receipt of communication.
- Having fulfilled his obligations, the underwriter is entitled to underwriting commission and brokerage at the agreed rate, subject to limits under the companies Act, within 15 days from the date of completion of allotment.

In case the underwriter fails to meet his obligations regarding devolved amount within 30 days of the communication, the issuing company can take necessary measures and commence proceeding against the underwriter including the right to claim damages for ay loss suffered due to default by the underwriter.

C) **Bankers to the Issue**

Bankers to the issue constitute yet another important intermediary in the new issues market. They are engaged in activities such as acceptance of applications along with application money from the investors in respect of issue of capital and refund of application money.

The banker to the issue, just like other intermediaries, is subject to different rules and regulations and a code of conduct. The major obligation of a banker to an issue can be briefly stated as follows:

- Each banker to an issue has to enter this an agreement with the issuing company detailing the number and addresses of collection centres at which applications and application money are to be received, the fee for the services and other terms and conditions of the appointment.
- The designated controlling branch of the banker to an issue has to submit to the issuing company/registrar to an issue a daily statement giving the details regarding the number of applications and the amount of money received from the investors.
- A banker to an issue has to submit the following information to SEBI:
  - i) The details of issues for which he has been engaged as a banker to an issue;
  - ii) The number of applications and the details of application money received;
  - iii) The date-wise details when applications from were forwarded to the issuing company/registrar to an issue; and
  - iv) The date-wise details of the amount of refund to the investors

A banker to an issue is duty bound to inform SEBI about any RBI action taken against him regarding issue payment. SEBI registration is deemed to be suspended/ cancelled it the banker to an issue has been prohibited to carry on his activities due to such disciplinary action.

- A banker to an issue has to maintain books of accounts, records and documents pertaining to all matters regarding which he may be required to submit details to SEBI, including the names and addresses of the investors, for a minimum period of three years form the completion of the issue.
- A banker to an issue has to adhere to the prescribed code of conduct, which is similar to that for a merchant banker or an underwriter. In addition, he should be adhere to the following:
  - i) do not keep blank application forms bearing broker's stamp at the work premises or at the entrance of the bank.
  - ii) do not accept application after office hours, or on bank holidays, or after the date of the closure of issue.
  - iii) do not act at any time in collusion with other agents in a manner detrimental to the interest of small investor.
  - iv) abide by all acts, rules, regulations, notifications, directions, circulars, instructions and guidelines issued by the Government, RBI, Indian Banks Association and SEBI which are relevant to his operations as a banker to an issue.

In case of default, SEBI is empowered to (a) suspend the registration certificate, or (b) cancel the registration certificate of a banker to an issue.

D) **Brokers to the Issue**

Brokers are the persons mainly concerned with the procurement of subscription to the issue from the prospective investors. The appointment of brokers is not compulsory and the companies are free to appoint any number of brokers. The managers to the issue and the official brokers organise the preliminary distribution of securities and procure direct subscriptions from as large or as wide a circle of investors as possible. Their active assistance is indispensable for broadbasing the issue and attracting investors. By and large, the leading merchant bankers in India who act as managers to the issue have particulars of the performance of brokers in the country. The company in consultation with the stock exchange writes to all active brokers of all exchanges and obtain their consent to act as brokers to an issue. Thereby, the entry of an experienced and unknown agencies in the field of new issue activity as issue managers, underwriters, brokers and so on is discouraged.

Brokers have to work within the guidelines prescribed by the SEBI; they have also to observe the bye-laws laid down by the stock exchanges.

E) **Registrars to an Issue and Share Transfer Agents**

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

The share transfer agents maintain the records of holders of securities or on behalf of companies, and deal with all matters connected with the transfer/redemption of its securities.

To carry on with their activities, registrars and the share transfer agent must be registered with the SEBI which can also renew the certificate of registration. The registration is granted by the SEBI on the basis of the consideration of all relevant matters and, in particular, the necessary infrastructure, past experience and capital adequacy. It also takes into account the fact that any connected person has not been granted registration and any director/partner/principal officer has not been convicted for any offence involving moral furniture or has been found guilty of any economic offence.

A registrar/share transfer agent who fails to comply with any condition to which registration is granted, or contravenes any of the provision of the SEBI Act, rules/ regulations and stock exchange bye-laws, rules and regulations i.e, liable to suspension or cancellation of registration.

Check Your Progress 1

1) Describe in brief the two components of financial markets. How is secondary market different than the primary market?

....

....

....

....

....

2) What are functions of merchant bankers ? What are their obligation?

....

....

....

....

....

3) State in brief the obligation of a banker to an issue.

....

....

....

....

....

8.4 SECONDARY MARKET STRUCTURE

Secondary market in India has shown maturity by registering enormous growth in recent years in terms of the number of listed companies, market capitalisation, market value listed companies to GNP, number of shareholders, and so on. There are 23 recognised stock exchanges in the country. The organisation of stock exchange varies: 14 are public limited companies, 6 are companies limited by guarantee and 3 are voluntary non-profit organisations. Besides stock exchange, an efficient depository system and a system that provides custodial services have been developed. These are all sign of growing maturity of secondary market in India.

8.4.1 Stock Exchanges

After the initiation of reforms in 1991, the Indian secondary market has a three-tier form:

i) Regional Stock Exchanges

ii) National Stock Exchange (NSE)

iii) Over the Counter Exchange of India (OTCEI).

The NSE was set up in 1994. It was the first modern stock exchange to bring in new technology, new trading practise, new institution and new products. The OTCEI was set up in 1992 as a stock exchange providing small and medium sized companies the meant o generate capital.

In all, there are 23 exchanges in India – 19 regional stock exchanges, BSE, NSE, OTCEI and the Interconnected Stock Exchange of India (ISE). The ISE is a stock exchange of stock exchanges. The 19 regional stock exchanges are located at Ahmedabad, Bangalore, Bhubneshwar, Kolkata, Cochin, Coimbatore, Delhi, Guwahati, Hyderabad, Indore, Jaipur, Kanpur, Ludhiana, Chennai, Mangalore, Pune, patina, Rajkot and Vadodara. They operate under the rules, by-laws and regulations approved by the government and SEBI.

The regional stock exchanges are managed by a governing body consisting of elected and nominated members. The trading members, who provide working services, own, control and manage the exchanges. The governing body is vested with wide ranging powers to elect office bearers, set up committees, admit and expel members, manage properties and finances of the exchange, resolve disputes and conduct day-to-day affairs of the exchange.

The OTCEI and NSE are demutualised exchanges wherein the ownership and management of the exchange are separated from the right to trade on exchange.

Brokers are members of the stock exchanges. They enter trade either on their account or on behalf of their clients. They are given a certificate of registration by SEBI and they have to comply with the prescribed code of conduct. Over a period of time, many brokers with proprietary and partnership firms have converted themselves into corporate entities.

Check Your Progress 2

1) Mention the role and responsibilities of underwriters in an issue of new capital.

....

....

....

....

....

2) Who are 'bankers to an issue'? What are their functions.

....

....

....

....

....

3) What are stock exchanges?

....

....

....

....

....

8.4.2 Depository System

In the post-liberalisation period, as the capital markets matured there too place a tremendous increase in the volume of activity. The traditional settlement and clearing system proved to be inadequate due to operational inefficiencies. Hence, there emerged a need to replace this traditional system with a new system called ‘Depository System’.

Depository , in very simple words, means a place where something is deposited for safekeeping. A depository is an organisation which holds securities of a shareholder in an electronic form and facilitates the transfer of ownership of securities on the settlement dates.

The depository system revolves around the concept of paperless or scripless trading because the shares in a depository are held in the form of electronic accounts, i.e., in a dematerialised form. This system is similar to the opening of an account in a bank wherein a bank with hold money on behalf of the investor and the investor has to open an account with Bank to utilise its services. Cash deposits and withdrawals are made in a bank, in lieu of which a receipt and a passbook are given, while in depositories, scrips are debited and credited and an account statement is issued to the investor from time to time. An investor in a bank deals directly with a bank while an investor deals through a depository participant in a depository.

The need for depository system arose primarily because of the following factors:

- Inordinate delays in transfer of securities.
- Return of share certificate as bad deliveries on account of forged signatures/ mismatch of signatures or face certificate/forged transfer deed.
- Delay in the receipt/non-receipt of securities after allotment / refund orders to non-allottees.
- Delay in getting duplicate shares/debentures, certificates, and
- Inadequate infrastructure in banking and postal segments to handle a large volume of application and storage of share certificates.

The bottlenecks became more pronounced with every increase in the number of investors and volume of trading in securities.

In response the depositories Act 1996 was enacted. The Act vests SEBI with the powers of registration of depositories and participants and to approve or amend the bye-laws of a depository. The National Securities Depository limited (NSDL) was set up in 1996. the NSDL was sponsored by the IDBI, the UTI and the NSE.

The system of depositories has the following characteristics:

- The holders of existing securities have choice of either continuing with the existing share certificate or opt for the depository mode.
- Issuers of new securities give an option to investors either to opt for physical delivery of share certificates or join the depository made.
- The investors opting for depository mode continue to enjoy the economic benefits form the shares and the voting rights.
- The shared in depositories are fungible, ie,. They do not have distinct number or distinct identity.
- Investors are allowed exist from the depository and they can claim share certificate form the company by getting their names substituted as the registered shareholder in place of the depository.

- After opting for depository mode, the share certificates of the investors get dematerialised and their names are entered in the books of participants as beneficial owners. In the register of the name of the depository as the registered owner of securities.
- The investors joining the depository system have to register with or more participants who are agents of the depositories. Such participants are custodial agencies, such as banks, financial institutions, etc.,

Safeguards have been built into the regulations to prevent manipulation of records and transactions in the depository system. The safeguards include protection against unauthorised access to systems, standard transmission and prescribed formats for electronic communication, controlled access mechanisms to data storage procedure and facilities for ensuring protection of records against loss or destruction and arrangements for back-up of records and data. The provision is also to be made for insurance and other arrangements for indemnifying the beneficial owners.

Benefits of depositories to various interest groups are as follows:

I) Benefits to investors. Depository system benefits investors in the following ways:

- Speedy transfer of shares, etc
- Facility of dematerialisation and rematerialisation
- Trading risks avoided
- Indemnification of certain losses
- Risk of fake and stolen shares avoided
- Daily reconciliation also protects investors
- Share transfer cannot be refused
- Beneficial owner to be the actual owner
- No Stamp duty
- Low brokerage cost
- Low custody charges
- Dematerialise securities are highly fungible
- Periodic consolidated information

II) Benefits to the Issuer. The issuers get the following benefits:

- It facilitates proper distribution of benefits to the beneficial owners of the securities
- The volume of paper work comes down
- Depositories facilitate wider spread of shareholding over a large geographical area

III) Benefits to the Intermediaries. These are as follows:

- As the problem of bad delivery or fake shares get eliminated form the system, banks and other lending institutions find it easier and safer to lend funds against dematerialised securities.

- The brokerage rates come down

IV) Benefits to lending Banks. These are as follows:

- Freedom from replacing securities in case, of book closures and would have been the case for physical shares.
- Facilitates immediate transfer of securities in the bank's name in the event of default by the borrower, thereby giving an immediate opportunity to the bank to sell.
- Makes switching of portfolio convention.
- Results in lower processing cost as handling of papers is minimised.
- Simplifies creation of bank's charge on securities bent against, thereby freeing the bank from the problems arising out of transfer deeds and other related matters.

In short, an effective and fully developed depository system is essential for maintaining and enhancing market efficiency, which is one of the core characteristics of a mature capital market.

8.4.3 Custodial Services

The provision of efficient custodial services forms an important element in the evolution of a mature stock market system.

Custodian services are provided by the custodians. Custodian services are different than depositories. A custodian is an intermediary who keeps the scarps of the clients in custody or is the keeper of the accounts of its clients. A custodian is not only a safe keeper of share certificates and a trustee of the same but also provides ancillary services such as physical transfer of share certificates, collecting dividends and investment warrants, and conforming to transfer regulations. Besides these, it updates clients on their investment status. To claim benefits on behalf of its clients, a record dates, bonus and rights issues.

Recognising their importance in the securities market, the SEBI custodian of Securities Regulations 1996 was framed for the proper conduct of their business. According to SEBI regulations, custodial services in relation to securities mean (i) safe-keeping of the securities of a client who enters into an agreement to avail of these securities, and (ii) providing services incidental thereto.

Stock Holding Corporation of India Ltd (SHCIL)

SHCIL was promoted by seven all – India financial institutions – IDBI, ICICI, IFCI, IRBI, UTI, LIC, GIC and its subsidiaries – was incorporated in 1986. It commenced operations in 1988.

SHCIL was established to provide well-developed and fully automated infrastructural facilities for trading, clearance, settlement, and depository services for securities and monetary instruments. The objectives of the SHIL are to provide services which include market operations, corporation actions, safekeeping, custodian management, registration, transfer and reporting. Support services include fund transfer and data bank information feeds. SHCIL handles market operations and provides custodial services to financial institutions and mutual funds. Apart from rendering custodial services, it also handles transfers and collects dividends and interest in respect of securities on behalf of sponsoring institutions, stock brokers and other investors. Its business is dividend into five groups: clearing services, registration/transfer, processing, safekeeping, corporate action and benefits collections and management information system (MIS).

Check Your Progress 3

1) What are stock exchanges ? What are their functions?

....

....

....

....

2) Bring out the need and role of depository system in secondary markets.

....

....

....

....

3) What do you mean by custodial services? What in their significance?

....

....

....

....

8.5 LET US SUM UP

1) Financial markets are classified as
   i) primary markets and
   ii) secondary markets
2) Primary market deals in the new financial claims and new securities, and therefore, is also known as the new issues market
3) Secondary market deals in securities already issued or existing or outstanding
4) SEBI is the regulatory authority both for the primary market and the secondary market
5) In the primary market main principal market intermediaries are:
   i) merchant bankers
   ii) underwriters
   iii) bankers to the issue, and
   iv) registrars and share transfer agents
6) In the secondary market, principal role is played by the stock exchanges. Recent innovation include depository system and custodial services.

8.6 KEY WORDS

Brokerage : It is the commission charged by the brokers for purchase/sale transactions done through them.

Dematerialisation : It is the process by which shares in the physical/paper from are cancelled and credit in the form of electronic balance is maintained on highly secure system at the depository

Rematerialisation : It is the process through which shares in electronic form in depository are converted into physical form

Settlement : It refers to scrip-wise netting of trades by a broker after the trading period is over

Transmission : It is the lawful process by which the ownership of securities is transferred to the legal heir of the deceased.

8.7 SOME USEFUL BOOKS

Bhole, L.M, (2004). *Financial Institutions and Markets*, Tata McGrawHill, New Delhi.

Khan, M.Y. (2003), *Indian Financial System* Tata McGraw, New Delhi.

Pathak, Bharati V. (2003), *Indian Financial System*, Pearson, New Delhi.

8.8 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See section 8.2

2) See section 8.3.2

3) See section 8.3.2

Check Your Progress 2

1) See section 8.3.2

2) See section 8.3.2.

3) See section 8.4.1

Check Your Progress 3

1) See section 8.4.1

2) See section 8.4.2

3) See Section 8.4.3.