CHAPTER 8

INSTITUTIONS AND INTERMEDIARIES

LEARNING OUTCOMES

After going through the chapter student shall be able to understand:

- Depository
- Stock and Commodity Exchanges – Indian and Global
- Intermediaries
- Institutional Investors
- FPIs
- Custodians
- Clearing Houses

CHAPTER OVERVIEW

- Institutions and Intermediaries
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- Stock and Commodity Exchange
  - Indian
  - Global
- Intermediaries in the Capital Market
  - Merchant Bankers
  - Registrars to an issue & Share Transfer Agents
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  - Stockbrokers and Sub-broker
  - Institutional Investors
  - Foreign Portfolio Investros (FPIs)
  - Custodians
  - Clearing House

1. DEPOSITORY

Depository in simple terms means a place where security is kept safely. Depository is an organization which keeps securities in electronic form and helps in the transfer of ownership of securities. As per section 2(e) of the Depositories Act, 1996, 'Depository means a company formed and registered under the Companies Act, 2013 and which has been granted a certificate of registration under Securities and Exchange Board of India Act, 1992.'

In the depository system, transactions in securities are done entirely on paperless or electronic basis. This is quite like the banking system where one opens an account with a bank. Similarly, in the case of depository system, an investor willing to invest in the securities market opens an account (which is called a 'Demat Account') with a depository. Whenever securities are allotted to a particular investor, his account will be credited. In the same way, whenever any securities are sold by that investor, his demat account will be debited by the number of shares sold by him. A depository also acts as a securities bank where dematerialized securities in electronic are kept in safe custody.

1.1 Benefits of a Depository System

To the Investors

i) It eliminates bad deliveries of securities.

ii) The settlement cycle has become quicker. It is now T + 2.

iii) Immediate transfer and registration of securities are possible now.

iv) It eliminates the risks present in physical certificate for e.g., forgery, delays, mutilation, theft, and damage of share certificates.

v) The electronic transfer of securities enables the investor to get dividends, bonus shares and right shares quickly.

vi) Transaction costs are lower as transfer of securities in electronic form is exempt from stamp duty.

vii) Further, as trading in the depository system is paperless, no share certificate and share transfer deed is required.

viii) Lastly, the rate of interest on loan against the pledged demat shares are lower in comparison to physical shares.

To the Company

i) The depository system helps a company to maintain and update its shareholding pattern periodically. The company always has knowledge of the beneficial ownership and their holdings.

ii) The cost of issue of securities also gets lowered because of dematerialisation of securities.

iii) Another advantage of the depository system is that many transactions can be settled promptly.

(iv) Distribution of dividends and issuance of rights shares and bonus shares will be quicker as the ownership can be easily identified.

v) The transfer process under the depository system is quick and without any defects. Therefore, complaints against the company by investors have been drastically reduced in this respect.

To the Capital Market

i) The capital market is more transparent, as trading, clearing and settlement are automatic and always inter linked with the depository.

ii) Use of latest technology in the depository system has made the capital market activities more efficient.

iii) That has made the investors have more confidence in the capital market.

iv) Use of depository system has attracted foreign institutional investors in large numbers.

v) Use of electronic system has made the Indian Capital Market more flourishing. For instance, we can take the example of mutual funds which have increased substantially in the last few years.

1.2 The Process of Depository System

Four parties are involved in a depository system i.e., the customer, the depository participant (DP), the depository, and the share registrar and transfer agent. The process of the depository system and the involvement of the four parties as mentioned above are discussed as below:

(a) **Account Opening:** An investor who wishes to avail the depository services must apply for opening an account with a depository through a Depository Participant (DP). A depository participant can either be a custodian, a bank, a broker, or an individual. After opening an account, the investor is allotted a client account number. The holder of a demat account is called a 'beneficial owner'. He has the option of opening more than one demat account either with the same DPs or multiple DPs.

(b) **Dematerialization:** To convert physical shares into electronic ones, an investor has to make an application to the depository in a Dematerialization Request Form (DRF). DP forwards the form within seven days to the issuer company or its Registrar and Share Transfer Agent (RTA). The company or its RTA, then verifies the validity of the security certificates and the fact the person making an application is a registered member. After verification, the issuer company, or its RTA, on being satisfied, authorizes an electronic credit of security in favour of the investor. Thereafter, the depository also credits the demat account of the investor.

(c) **Rematerialisation:** An investor having a demat account can apply for withdrawal of balance in his account in a Rematerialisation Request Form (RRF). On receipt of the RRF, if the DP is satisfied that there is sufficient balance, will block the balance of the investor to the extent of the rematerialisation quantity and electronically forwards the request to the depository. The depository will then block the balance of the investor to the extent of the rematerialisation quantity and forward the accepted rematerialisation application to the issuer or its Registrar and Share Transfer Agent (RTA). The RTA will confirm that RRF has been accepted. Then, the RTA will dispatch the physical share certificates within 30 days.

(d) **Distributing Dividend:** A company or its RTA generally informs the depository of various dates such as book closures, redemption, or maturity of security etc. This enables the depository to electronically provide the company a list of the holdings of the investors on the day of distribution of dividend. The company will, then, distribute dividends on the basis of the list provided.

(e) **Closing an Account:** If an investor wants to close his account, he shall make an application in the prescribed format to the DP. The DP may close his account if no balances are there in the investor's demat account. If any balances exist, then the account may be closed either by rematerialisation or transferring his securities to another account either with the same depository participant or with a different depository participant.

2. STOCK AND COMMODITY EXCHANGES – INDIAN AND GLOBAL

Stock exchanges are meant to facilitate mobilization of resources by companies. However, the regulation of stock exchanges is necessary to protect the interests of investors and safeguard the role of stock exchanges about the development of the capital market.

Stock exchanges are basically regulated by SEBI. The recognition given to a stock exchange to function in the capital market is given by SEBI. The Securities Contracts (Regulation) Act 1956 along with the Securities Contracts (Regulation) Rules 1957 has been the main laws to regulate the securities market in India. As per the Securities Contracts Regulations Act, 1956 a stock exchange is defined as "an association, organization or body of individuals whether incorporated or not, established for the purpose of assisting, regulating and controlling business in buying, selling and dealing in securities".

2.1 Growth of Stock Exchanges

The history of Stock Exchanges in India goes back to the eighteenth century, when securities of the East India Company were transacted. There were 50-60 brokers led by the legendary Premchand Roychand. They formed the backbone of share floatation by East India Company and a few commercial banks. Corporate shares made their entry in the 1830s and assumed significance with the enactment of the Companies Act in the 1850s. The Bombay Stock Exchange, the oldest stock exchange in India was established in 1875 under the name, Share and Stockbrokers Association.

The stock exchanges are tightly regulated as self-regulatory organizations (SROs) under the Act. In addition to ordinary regulatory powers over the stock exchanges, the Central Government and/or SEBI may nominate up to three members to the board of each stock exchange [Section 4(2) (iii) of the SC (R) Act, 1956 and Section 10 of SC(R) Rules, 1957]. The government and/or the agency have the authority to make, approve and amend the byelaws of the stock exchanges [Section 4(1)(a) &8 of the SC(R) Act, 1956]. In return, the stock exchanges have been granted strong disciplinary authority (as well as obligations) over their member stockbrokers.

2.1.1 Leading Stock Exchanges in India

The two leading stock exchanges in India are Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). A brief about them has been discussed as below:

(a) **Bombay Stock Exchange Limited:** It is the oldest stock exchange in Asia and was established as "The Native Share & Stockbrokers Association" in 1875. The Securities Contract (Regulation) Act, 1956 gives permanent recognition to Bombay Stock Exchange in 1956. BSE became the first stock exchange in India to obtain such permission from the Government under the Act.

The Exchange's pivotal and pre-eminent role in the development of the Indian capital market is widely recognized and its index, *SENSEX*, is tracked worldwide. Earlier, an Association of Persons (AOP), the Exchange is now a demutualized and corporatized entity incorporated under the provisions of the Companies Act, 1956, pursuant to the BSE (Corporatization and Demutualization) Scheme, 2005 notified by the Securities and Exchange Board of India (SEBI).

The Exchange has nationwide coverage. The BSE's systems and processes are designed in such a way that it safeguards the integrity of the market and ensures transparency in its operations.

Therefore, the traders can freely trade in equity, debt, and derivative instruments as they are pretty much sure of the BSE's transparent and efficient operations. The BSE's Online Trading System (BOLT) is a proprietary system of the Exchange and is BS 7799-2-2002 certified. Similarly, the surveillance and clearing & settlement functions of the Exchange are ISO 9001:2000 certified.

(b) **National Stock Exchange:** NSE was incorporated in 1992. It was recognized as a stock exchange by SEBI in April 1993 and commenced operations in 1994 with the launch of the wholesale debt market, followed shortly after the launch of the cash market segment.

NSE also has strategic investments in complementary businesses, including mutual fund registry services, back-end exchange support services for its platforms, depository services, e-corporate governance and commodity, power and receivables exchanges.

The National Stock Exchange of India Ltd. (NSE) is the leading stock exchange in India and the second largest in the world by number of trades in equity shares from January to June 2018, according to World Federation of Exchanges (WFE) report.

NSE launched electronic screen-based trading in 1994, derivatives trading (in the form of index futures) and internet trading in 2000, which were each the first of its kind in India.

NSE has a fully integrated business model comprising our exchange listings, trading services, clearing and settlement services, indices, market data feeds, technology solutions and financial education offerings. NSE also oversees compliance by trading and clearing members and listed companies with the rules and regulations of the exchange.

NSE is a pioneer in technology and ensures the reliability and performance of its systems through a culture of innovation and investment in technology. NSE believes that the scale and breadth of its products and services, sustained leadership positions across multiple asset classes in India and globally enable it to be highly reactive to market demands and changes and deliver innovation in both trading and non-trading businesses to provide high-quality data and services to market participants and clients. *[Source: NSE Website]*

2.1.2 Stock Exchanges Abroad

With the increasing globalization and liberalization, the prices of securities on Indian stock exchanges are influenced by stock exchanges abroad. Under this heading we have tried to give a brief introduction of the major stock exchanges abroad.

(a) *New York Stock Exchange (NYSE):* The New York Stock Exchange was established more than 200 years ago in 1792. NYSE is the world's foremost securities marketplace.

Each day on the NYSE trading floor an auction takes place. Open bids and offers are made by investors which are efficiently managed by exchange members who act on behalf of institutions and individual investors. Prices are determined through the forces of demand and supply. Buy and sell orders given by investors for the listed securities are given an assigned location where a NYSE member from employed broker acts as an auctioneer in an open outcry market. However, from January 24, 2007, onwards NYSE stocks are also being traded electronically.

(b) *Nasdaq:* Nasdaq is known for its growth, liquidity, depth of market and the world's most powerful, forward-looking technologies. This makes NASDAQ the leading choice of some of the well-known companies in the world. NASDAQ was founded in 1971. Since then, it has outformed the other market to become the fastest growing stock exchange in the USA. In Nasdaq, trading takes place in electronic trading platform having the highest level of efficiency.

As Nasdaq is one of the world's most popular stock exchanges, the companies to get listed on it must satisfy the strictest earnings, capitalization and corporate governance norms.

In contrast to NYSE, the Nasdaq is a fully electronic trading platform for securities. So, it has no individual specialist broker through which the transactions go through. Nasdaq's market structure is such that it allows many participants to undergo trading in stocks though a highly sophisticated computer network. Together, these participants help ensure transparency and liquidity for a company's stock while maintaining an orderly market and functioning under tight regulatory controls.

(c) *London Stock Exchange*: The history of the formation of the London stock exchange can be traced back to 1760 when 150 brokers fired from royal Exchange for misbehavior formed a club at Jonathan's Coffee House to buy and sell shares. In 1773, members voted to change the name to Stock Exchange and 2000 shareholders voted it to become a public limited company and thus the London Stock Exchange was formed. Dealing in shares is conducted via an off-market trading facility operated by Cazenove and Co.

London Stock Exchange provides a range of services for companies and investors:

(i) ***Company Services -***It provides several markets which allow companies large and small to raise capital, and a range of services to increase the profile of the companies.

(ii) ***Trading Services -***It gives market users access to a well-developed trading environment with a proven record of stability and flexibility.

(iii) ***Information Services -*** It provides high quality real-time price information to market users worldwide, as well as historical and reference data.

Supporting these activities, the exchange regulates the markets to give protection to investors and companies and to maintain its reputation for high standards and integrity. In addition, in partnership with others, it helps to track the performance of the markets through various indices.

2.2 Characteristics of Stock Exchanges in India

Stock exchange is an association of individual members called brokers. It is formed with the aim of regulating and facilitating the buying and selling of securities by retail investors and institutions. Corporate membership of stock exchanges was introduced lately.

A stock exchange is typically governed by a board consisting of directors. Some Members of the Board have been nominated by the Government. Government nominees include representatives of the Ministry of Finance, as well as some public representatives, who are expected to safeguard the interest of investors in the functioning of the exchanges. The board is headed by a President, who is an elected member, usually nominated by the government, from among the elected members. The Executive Director, who is appointed by the stock exchange with government approval, is the operational chief of the stock exchange. His duty is to ensure that the day-to-day operations of the stock exchange are carried out in accordance with the rules and regulations governing its functioning.

Securities and Exchanges Board of India (SEBI) has been set up in Mumbai by the Government to oversee the orderly development of stock exchanges in the country. Every company which wishes to raise capital from the public is required to get its securities listed on atleast one stock exchange. Thus, all ordinary shares, preference shares and debentures of publicly held companies are listed in one or more stock exchanges.

2.3 Functions of Stock Exchanges

The Stock Exchange is a marketplace where investors buy and sell securities. Functions of the stock exchanges can be summarized as follows:

(a) Liquidity and Marketability of Securities: The basic function of the stock market is the creation of a continuous market for securities, enabling them to be liquidated, where investors can convert their securities into cash at any time at the prevailing market price. It also provides investors with the opportunity to change their portfolio as and when they want to change, i.e. they can at any time sell one security and purchase another, thus giving them marketability.

(b) Fair Price Determination: The stock market is almost a perfectly competitive market. The reason is that there are large number of buyers and sellers, near perfect information and active bidding from both the buyer's and the seller's side. The reasons as mentioned above ensure that fair price is determined by the forces of demand and supply.

(c) Source for Long term Funds: Corporates, Government and public bodies raise funds from the equity market. These securities are negotiable and transferable. They are traded and change hands from one investor to the other without affecting the long-term availability of funds to the issuing companies.

(d) Helps in Capital Formation: Savings and investments of the people are closely interrelated. The savings of the community are mobilized and channeled by stock exchanges for investment into those sectors and units which are favoured by the community at large, based on such criteria as good return, appreciation of capital, and so on. It is the preference of investors for individual units as well as industry groups, which is reflected in the share price that decides the mode of investment.

Stock exchanges render this service by arranging for the preliminary distribution of new issues of capital, offered through prospectus, as also offers for sale of existing securities, in an orderly and systematic manner. They themselves administer the same, by ensuring that the various requisites of listing (such as offering at least the prescribed minimum percentage of capital to the public, keeping the subscription list open for a minimum number of days, enlisting prescribed centres for receiving of applications, allotting shares against application received are complied with.

Stock exchanges also provide a forum for trading in rights shares of companies already listed, thereby enabling a new class of investors to take up a part of the rights in the place of existing shareholders who renounce their rights for monetary considerations.

(e) Reflects the General State of Economy: The way stock markets perform is indicative of the manner of economic health of a country i.e. whether the economy is undergoing boom or depression. It indicates the general state of the economy to all those concerned, who can take suitable steps in time. The Government takes suitable monetary and fiscal steps depending upon the state of the economy.

2.4 Indian Commodity Exchanges

Presently four national commodity exchanges are operational: National Multi-Commodity Exchange of India (NMCE), Indian Commodity Exchange (ICEX), National Commodity and Derivatives Exchange (NCDEX) and Multi Commodity Exchange (MCX).

(a) *National Commodity & Derivatives Exchange Limited (NCDEX):* NCDEX is a professionally managed online multi commodity exchange. It is promoted by ICICI Bank Limited (ICICI Bank), Life Insurance Corporation of India (LIC), National Bank for Agriculture and Rural Development (NABARD) and National Stock Exchange of India Limited (NSE), Punjab National Bank (PNB), CRISIL Limited (formerly the Credit Rating Information Services of India Limited), Indian Farmers Fertiliser Cooperative Limited (IFFCO), Canara Bank and Goldman Sachs by subscribing to the equity shares of the Exchange. NCDEX is the only commodity exchange in the country promoted by national level institutions.

NCDEX is a public limited company incorporated on April 23, 2003, under the Companies Act, 1956. It commenced its operations on December 15, 2003.

It is a national level, technology driven demutualized on-line commodity exchange with an independent Board of Directors and professionals not having any vested interest in commodity markets. It is committed to providing a world-class commodity exchange platform for market participants to trade in a wide spectrum of commodity derivatives driven by best global practices, professionalism, and transparency.

Initially, it was regulated by the Forward Market Commission in respect of futures trading in commodities. However, FMC merged with SEBI in 2015. Now, SEBI is also the regulator of commodity exchanges. Further, NCDEX is also required to comply with various laws like the Companies Act, Stamp Act, Contract Act, SEBI Act, and various other legislations, which generally hamper its working.

(b) ***Multi Commodity Exchange (MCX):*** MCX is an independent and demutualized multi commodity exchange. The government has given it permanent recognition for facilitating online trading, clearing and settlement operations for commodities futures market across the country.

Because of the opportunities galore offered by the MCX to a large cross section of participants including producers/ processors, traders, corporate, regional trading centre, importers, exporters, co-operatives, and industry associations amongst others, it offers trading in more than 30 commodity futures contracts. The headquarters of MCX is in Mumbai. Further, it is led by an expert management team with good knowledge of the commodities futures market.

Being a nation-wide commodity exchange having state-of-the-art infrastructure, offering multiple commodities for trading with wide reach and penetration, MCX is well placed to tap the vast potential posed by the commodities market.

The key shareholders of MCX are Financial Technologies (I) Ltd. (now, 63 Moons Technologies Limited), State Bank of India and its' associates, National Bank for Agriculture and Rural Development (NABARD), National Stock Exchange of India Ltd. (NSE), Fid Fund (Mauritius) Ltd. - an affiliate of Fidelity International, Corporation Bank, Union Bank of India, Canara Bank, Bank of India, Bank of Baroda, HDFC Bank and SBI Life Insurance Co. Ltd.

(c) ***Indian Commodity Exchange (ICEX):*** It is a screen based on-line derivatives exchange for commodities. It has robust assaying and warehousing facilities to facilitate deliveries. It has Reliance Exchange Next Ltd. as anchor investor and has MMTC Ltd., India Bulls Financial Services Ltd., Indian Potash Ltd., KRIBHCO and IDFC among others, as its partners.

The head office is in Mumbai and has regional offices spread across the country which covers agri belt, with a vision to encourage participation of farmers, traders, and actual users to hedge their positions against the wide price fluctuations.

It provides the widest range of benchmark future products available on any exchange, covering all major commodities. It offers future trading in Agriculture Commodities, Bullions, Base Metals and Energy.

(d) *National Multi-Commodity Exchange of India (NMCE):* It is the first demutualized Electronic Multi-Commodity Exchange of India and has been granted the National status on a permanent basis by the Government of India. NMCE has been operational since 26th November 2002.

It is promoted by commodity-relevant public institutions, viz., Central Warehousing Corporation (CWC), National Agricultural Cooperative Marketing Federation of India (NAFED), Gujarat Agro-Industries Corporation Limited (GAICL), Gujarat State Agricultural Marketing Board (GSAMB), National Institute of Agricultural Marketing (NIAM), and Neptune Overseas Limited (NOL) and Punjab National Bank (PNB).

There are many positive features of NMCE. It is a zero-debt company and has been regularly following prudent accounting and auditing practices. The delivery mechanism is very good, which makes it the most suitable participants in the physical commodity market.

To attract speculative volume, the exchange does not compromise on delivery mechanism. The main motive is public interest rather than commercial considerations. It has transparent rule-based procedures which has almost eliminated any conflict of interest.

2.5 International Commodity Exchanges

Major international commodity exchanges of the world are briefly discussed as below:

- **Chicago Mercantile Exchange (CME):** It is a financial and commodity derivative trading platform which has its headquarter in Chicago. It was established in 1898 as the Chicago Butter and Egg Board. Presently, Chicago offers contracts of all kinds which include agriculture, credit, equity index, interest rates and other futures/options investments.
- **Chicago Board of Trade (CBOT):** It is formed in 1848 and being considered among oldest future/options trading exchanges in the world. The exchange offers more than 50 different futures and option contracts for investors which are scattered over several asset classes.
- **New York Mercantile Exchange (NYMEX):** The NYMEX is the world's largest physical commodity futures exchange, which offers a wide variety of products. Commodity Exchange

Inc. (COMEX), which acts as a division of the NYMEX, also offers exposure to various metals contracts.

- **London Metal Exchange (LME):** LME was established in 1877. However, it has its roots in 1571, when the Royal Exchange in London was founded, trading only copper at that time. It is a major exchange which offers exposure to futures and options of various varieties of base metals and other commodity products. Some of the metals which have been traded include aluminum, copper, tin, nickel, zinc, and lead.
- **Intercontinental Exchange Inc. (ICE):** The Intercontinental Exchange is an American company which operates futures and over-the-counter contracts through internet. In the beginning, the company was operating energy contracts but has increased its scope by offering exposure to several commodities including cocoa, cotton, sugar, iron ore, natural gas, and crude products.

3. INTERMEDIARIES IN THE CAPITAL MARKET

The following market intermediaries are involved in the Capital Market:

- Merchant Bankers
- Registrars to an issue and Share Transfer Agents
- Underwriters
- Bankers to issue
- Debenture Trustees
- Portfolio managers
- Stockbrokers and sub-broker

We will discuss them one by one in the following paragraphs:

3.1 Merchant Bankers

SEBI (Merchant Banker) Regulations, 1992, define 'merchant banker' as any person who is engaged in the business of issue management, either by making arrangements regarding selling, buying, or subscribing, or acting as a manager, consultant, or advisor, or rendering corporate-advisory services in relation to such issue management.

In case of both the public issues and right issues, it is mandatory to appoint a Merchant Banker. The task of Merchant Banker is basically that of a facilitator or coordinator. It coordinates the process of issue management by helping the underwriters, registrars, and bankers, in pricing and marketing the issue and complying with the SEBI guidelines.

Merchant Bankers are prohibited from carrying on certain activities such as acceptance of deposits, leasing, and bill discounting. They are not allowed to borrow any money from the market. They are also debarred from engaging in the acquisition and sale of securities on a commercial basis.

3.2 Registrars to an issue and Share Transfer Agents

'Registrar to an Issue' means a person who is involved with the following activities:

(a) Collecting applications on behalf of the investors and keep a proper record of monies received and paid.

(b) Helping the company which has issued shares in determining the basis of allotment of the securities in consultation with the stock exchange.

(c) Finalizing the list of persons entitled to allotment of securities.

(d) Processing and dispatching of allotment letters, share certificates and refund orders.

'Share Transfer Agent' means a person who on behalf of the issuer company maintains the records of holders of securities issued by such company.

The Registrars to an Issue and Share Transfer Agents are important intermediaries in the primary market. They help in mobilizing new capital and ensure that proper records of the details of the investors are maintained, so that the decisions regarding the basis for allotment and the number of securities to be allotted can be smoothly implemented.

3.3 Underwriters

An underwriter is a person who engages in the business of underwriting the public issue of securities of a particular company. An underwriting is an arrangement in which a SEBI registered underwriter gives an undertaking to the issuing company that in case the company's public issue is not fully subscribed, the underwriter will purchase the unsubscribed portion of the public issue.

Underwriting is compulsory for a public issue. It is necessary for a public company which invites public subscription for its securities to ensure that 90% of its public issue is fully subscribed, otherwise the whole issued amount must be refunded. The company cannot fully rely on advertisements to ensure full subscription. In case of any subscription, it must be made good by the underwriters. And the underwriting agreement must be made in advance of the opening of the public issue.

3.4 Bankers to an issue

Banker to an Issue means a scheduled bank doing any one of the following tasks:

(i) Acceptance of application money;

(ii) Acceptance of allotment or call money;

(iii) Refund of application money;

(iv) Payment of dividend or interest warrants.

Therefore, as the name indicates, bankers to the issue carries out the important task of ensuring that the funds are collected and transferred to the Escrow accounts. The banks do a great favour to the companies in mobilization of capital.

3.5 Debenture Trustee

A debenture trust deed is a document created by the company where debenture trustees are appointed to protect the interest of the debenture holders. To act as debenture trustee, the entity should either be a scheduled bank carrying on commercial activity, a public financial institution, an insurance company, or a body corporate. The entity should be registered with SEBI to act as a debenture trustee. The contract deed entered with a debenture trustee must specify the interest rate and date of interest and principal repayments.

Duties of the Debenture Trustee include:

(a) Call for periodical reports from the body corporate, i.e., issuer of debentures.

(b) Take possession of trust property in accordance with the provisions of the trust deed.

(c) Enforce security in the interest of the debenture holders.

(d) Ensure on a continuous basis that the property charged to the debenture is always available and adequate to discharge the interest and principal amount payable in respect of the debentures and that such property is free from any other encumbrances except those which are specifically agreed with the debenture trustee.

(e) Exercise due diligence to ensure compliance by the body corporate with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed.

(f) To take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice.

(g) To ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debenture holders.

(h) Inform the Board immediately of any breach of trust deed or provision of any law.

(i) Appoint a nominee director on the board of the body corporate when required.

(Source: SEBI FAQ's - Debenture Trustee)

3.6 Portfolio Managers

As per SEBI, a portfolio manager is a body corporate who, pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise), the management or administration of a portfolio of securities or the funds of the client.

Simply stated, a portfolio manager is a person who is responsible for investing a fund's assets, monitoring investment strategy and doing day-to-day trading. A portfolio manager manages mutual funds and other investment funds, such as hedge or venture funds. He may be an experienced investor, a broker, a fund manager, or a trader with good knowledge of industry and a having a track record of producing good results.

The portfolio manager provides the client with the Disclosure Document at least two days prior to entering into an agreement with the client. The Disclosure Document contains the quantum and manner of payment of fees payable by the client for each activity, portfolio risks, complete disclosures in respect of transactions with related parties, the performance of the portfolio manager and the audited financial statements of the portfolio manager for the immediately preceding three years. Please note that the disclosure document is neither approved nor disapproved by SEBI nor does SEBI certify the accuracy or adequacy of the contents of the Documents.

(Source: SEBI FAQ's - Portfolio Managers)

3.7 Stockbrokers and Sub-Broker

A stockbroker is a person who buys and sells stocks and other securities for its clients through a stock exchange. Stockbrokers should be registered with SEBI and are governed by SEBI Act and Securities Contract Regulation Act. Stockbrokers may also call themselves investment consultants and financial consultants. A stockbroker should have a good knowledge of the securities market. Further, he should be good with numbers, have excellent interpersonal skills and should be attentive enough not to oversee any important details.

On the other hand, a sub broker is a person who is not a trading Member of a Stock Exchange but who acts on behalf of a trading member as an agent. His task is to help investors in dealing in securities through such trading members(brokers). The leading stockbrokers in India are listed as below:

- India Infoline
- ICICI Direct
- Share Khan
- India Bulls
- Geojit Securities
- HDFC
- Reliance Money
- Religare
- Angel Broking

New Margin Rules for brokers and its implications

The new margin rules have come into effect from 1 September 2020 after SEBI's refusal to extend the deadline to implement the new rules on margin pledge any further. SEBI's new margin rules aim at bringing transparency and preventing brokerages from misusing clients' securities. These norms came out earlier in February 2020 and were initially scheduled to come into effect from June 1, 2020. The date was then extended to August 1, 2020, and thereafter to September 1, 2020. While the brokers and other participants requested more time to make their systems ready, SEBI's refused to extend this by saying there was enough time to make the changes.

Here are the changes:

- The stock will continue to remain in the investor's demat account and can be directly pledged to the clearing corporation. As the securities remain in investors' own demat account, they will enjoy all corporate benefits on their shares.

  Under the old system, cash margins were taken care of by the broker. Investors either had to transfer their shares to the brokers' account or give power of attorney (POA) to the broker. Some brokers went on to misuse the POA assigned to them.

- It is mandatory for brokers to collect margins from investors upfront for any purchase of sale of shares. Failing to do so will attract a penalty.
- No Power of Attorney (POA) to be assigned to brokers. The investors used to give authority to the brokers by way of POA to execute transactions on their behalf. The POA cannot be used for pledges anymore.
- Investors who want to avail margin now must create margin pledge separately.

- Earlier collecting upfront margin wasn't mandatory, but under the new system, investors will have to pay at least 30% margin upfront to avail themselves of a margin loan.
- Shares bought today cannot be sold tomorrow. Currently, investors can use intraday realized profits for taking new positions on the same trading day. According to the new norms, you will be able to use it only after T+2 days in case of equity/stocks once you receive the delivery of shares in your account.
- Till now, clients needed to meet margin requirements in their account once at the end of the day. But, the new margin rules of SEBI will require them to fulfill their margin obligations at the beginning of the deal. (*Source: Livemint*)

4. INSTITUTIONAL INVESTORS

An institutional investor is a large organization that has large cash reserves by which it invests in securities and other investment assets. Institutional investors include endowment funds, hedge funds, insurance companies, pension funds, mutual funds, etc. An institutional investor is basically a non-bank organization that trades in large quantities to qualify for preferential treatment. They are considered as specialized investors and supply capital to organizations that require funds or are in dire straits. Moreover, they exert good influence in the management of the corporations exercising voting rights.

So, basically, an institutional investor is an organization that invests on behalf of the investors. Institutional investors have the required resources to do detailed research on various investment avenues, and because of their extensive knowledge, they generally have an edge over retail investors. Various institutional investors are briefly discussed as below:

(i) Commercial Banks: They play an important role in taking deposits from the public and giving loans to various sectors of the economy. A sound banking system ensures that mobilized savings are effectively deployed to needy sectors of the economy. When banks provide loans in the form of working capital, they are providing loans for funding the current assets. The working capital loan should be short term in nature, and it is given in the form of a limit.

Banks provide long term loans for asset purchase as well as margin money for working capital purposes. In the case of asset purchase, a bank would provide a long- term loan which would be repaid either from the cash flow generated from the business or from refinancing or disinvestment. In such a case, security is generally created on the asset which is purchased out of the term loan. Besides, some other collateral is also taken as security in the form of term loan. In the case of term loans for working capital purpose, generally, other assets are taken as security. This asset can be immovable properties the borrower happens to have.

(ii) Insurance Companies: Insurance is basically the process of safeguarding the interests of people from loss and uncertainty. Insurance companies do a lot of service to the economy of the nation by protecting companies from contingencies and compensating them from any loss. They collect premiums for providing these services. The role and responsibilities of insurance companies have been outlined as below:

a) The insurance companies provide safety and security against a particular event.

b) They generate financial resources by collecting premiums and utilizing the premium amount for fruitful investment purposes.

c) Life insurance encourages savings through payment of regular premium amount.

d) The insurance companies promote economic growth by making accumulated capital into productive investment purposes. They help to reduce loss, bring financial stability by providing compensation at the time of any uncertain event and promote trade and commerce activities resulting in economic growth and development.

e) And, finally, insurance help in shifting of risk from the insured to the insurer.

(iii) Mutual Funds: Mutual Fund is a trust that pools together the savings of investors by making investments in the capital market thereby making the investor to be a part owner of the assets of the mutual fund. The fund is managed by a professional money manager who invests the money collected from different investors in various stocks, bonds, or other securities according to specific investment objectives as established by the fund. If the value of the mutual fund investments goes up, the return on them increases and vice versa. The net income earned from the funds, along with capital appreciation of the investment, is shared amongst the unit holders in proportion to the units owned by them. Mutual Fund is therefore an indirect vehicle for the investor investing in capital markets. In return for administering the fund and managing its investment portfolio, the fund manager charges fees based on the value of the fund's assets.

(iv) Pension Funds: A pension fund is a fund from which pensions are paid which are accumulated from contributions from employers and employees. Pension systems throughout the world have been under scrutiny over the last couple of decades. Numerous reforms have been carried out to tackle the sustainability and adequacy of pension arrangements in the face of the rising global demographic challenge.

In India, now Pension funds are regulated by Pension Fund Regulatory and Development Authority (PFRDA). Moreover, the funds contributed by the Subscribers are invested by the Pension Fund Regulatory and Development Authority (PFRDA) registered Pension Fund Managers (PFM's) as per the investment guidelines provided by PFRDA. The investment guidelines are framed in a very professional manner in such a way that there is negligible effect on the subscribers' contributions even if the market is not doing well by a prudent mix of investment vehicles like Government securities, corporate bonds, and equities.

(v) Endowment Funds: An endowment fund is an investment vehicle where periodic withdrawal from the money invested into the fund is possible. The money put into the endowment funds is often used by universities, nonprofit organizations, churches, and hospitals, and is generally used for specific requirement or to give a boost to the company's operating process.

An endowment fund is a financial asset, basically held by a non-profit organization, which contains the capital investments and related earnings used by the non-profit organization to fund the overall objective of the organization. Further, endowment funds are organized by stringent contractual obligations and rules to be followed by the non-profit organization. The main aim of the fund is to further the goal of the long-term financial health of the non-profit organization and its beneficiaries.

(vi) Hedge Funds: A hedge fund can be explained as a package of funds that takes both short and long positions, buys, and sells equities, initiates arbitrage, and trades bonds, currencies, convertible securities, commodities, and derivative products to give returns at minimum possible risk. The hedge fund tries to minimize risks to investor's capital against market volatility by employing various hedging strategies as outlined above. Hedge fund investors typically include High Networth Individuals (HNIs), endowments and pension funds, insurance companies, and banks. These funds work either as private investment partnerships or offshore investment companies.

5. FOREIGN PORTFOLIO INVESTORS (FPIs)

Who are FPIs?

FPIs are basically registered foreign funds, which put their money in the stock markets in India. They invest through various methods in the capital market, that is either in the debt segment or in the equity segment. Therefore, an FPI is an investor or investment fund that is registered in a country outside of the one in which it is currently investing. Institutional investors include hedge funds, insurance companies, pension funds and mutual funds. If we try to explain it in the Indian context, it refers to foreign companies investing in the financial markets of India. The Institutional investors based internationally must register with the Securities and Exchange Board of India (SEBI) to participate in the market.

Categorization of FPIs

Before making its investment in India, the FPI shall obtain a certificate of registration from a designated depository participant on behalf of the SEBI. They can be divided into following categories:

(a) Category I foreign portfolio investor" which shall include –

(i) Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by such Government and Government related investor(s);

(ii) Pension funds and university funds;

(iii) Appropriately regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker dealers and swap dealers;

(iv) Entities from the Financial Action Task Force member countries or from any country specified by the Central Government by an order or by way of an agreement or treaty with other sovereign Governments, which are –

(I) appropriately regulated funds;

(II) unregulated funds whose investment manager is appropriately regulated and registered as a Category I foreign portfolio investor:

Provided that the investment manager undertakes the responsibility of all the acts of commission or omission of such unregulated fund;

(III) university related endowments of such universities that have been in existence for more than five years;

(v) An entity (A) whose investment manager is from the Financial Action Task Force member country and such an investment manager is registered as a Category I foreign portfolio investor; or (B) which is at least seventy-five per cent owned, directly or indirectly by another entity, eligible under sub-clause (ii), (iii) and (iv) of clause (a) of this regulation and such an eligible entity is from a Financial Action Task Force member country:

Provided that such an investment manager or eligible entity undertakes responsibility of all the acts of commission or omission of the applicant's seeking registration under this sub-clause.

(b) "Category II foreign portfolio investor" shall include all the investors not eligible under Category I foreign portfolio investors such as –

(i) appropriately regulated funds not eligible as Category-I foreign portfolio investor;

(ii) endowments and foundations;

(iii) charitable organisations;

(iv) corporate bodies;

(v) family offices;

(vi) Individuals;

(vii) appropriately regulated entities investing on behalf of their client, as per conditions specified by the Board from time to time;

(viii) Unregulated funds in the form of limited partnership and trusts;

Explanation: An applicant incorporated or established in an International Financial Services Centre shall be deemed to be appropriately regulated.

An interesting fact about FPIs

Foreign Portfolio Investors have made good money in the last few years. However, the problem for the Indian markets is that if interest rates in the US rise, they may sell stocks they held in the Indian Stock Market to make higher yields in the US. The reason for this action is that they may earn higher return in the US than what they may earn by investing in the Indian Stock market. This may lead to high sell off in the Indian Capital market. So, interest rate hike by US Fed can influence the Indian Stock Market hugely.

Investment restrictions on FPIs

As per the SEBI (Foreign Portfolio Investors) Regulations), 2019

(1) A foreign portfolio investor shall invest only in the following securities, namely-

(i) shares, debentures and warrants issued by a body corporate; listed or to be listed on a recognized stock exchange in India;

(ii) units of schemes launched by mutual funds under Chapter V, VI-A and VI-B of the Securities and Exchange Board of India (Mutual Fund) Regulations, 1996;

(iii) units of schemes floated by a Collective Investment Scheme in accordance with the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999;

(iv) derivatives traded on a recognized stock exchange;

(v) units of real estate investment trusts, infrastructure investment trusts and units of Category III Alternative Investment Funds registered with the Board;

(vi) Indian Depository Receipts;

(vii) any debt securities or other instruments as permitted by the Reserve Bank of India for foreign portfolio investors to invest in from time to time; and

(viii) such other instruments as specified by the Board from time to time.

Recent Trends

Foreign portfolio investors (FPIs) remained net sellers in Indian markets in July 2020 so far on account of both domestic and global factors, including rising number of coronavirus cases and increasing tension between the US and China.

According to the depositories data, overseas investors invested ` 2,336 crore in equities but pulled out ₹ 2,422 crore from the debt segment, leading to net outflows of ₹ 86 crore from Indian markets between July 1-24. In the previous month i.e., June 2020 FPIs were net buyers to the tuneof ₹ 24,053 crore. (*Source: Livemint*)

About 70% of the foreign portfolio investor (FPI) inflows into Indian equities in the month of October 2020 have gone into two sectors — banking and technology, according to NSDL data. These investors have pumped ₹ 16,945 crore into local stocks in October. Out of this, they have invested nearly ₹ 9,500 crore in banking stocks. Better-than-expected September quarter earnings, improvement in asset quality, and lower valuations because of the recent share underperformance FPIs' purchases in shares of private banks in October 2020.

FPIs put ₹ 3,327 crore into technology shares in October as the companies are cash-rich and their earnings have been resilient even when the disruptions on account of Covid-19 dragged down other sectors.

FPIs have also increased their stakes in automobiles, consumer discretions, capital goods, consumer durables and construction companies. Data show these investors have pulled out ₹ 871 cr from oil & gas companies, ₹ 847 crore from metals and a total of ₹ 350 crore from telecom and insurance sectors. (*Source: Economic Times*)

6. CUSTODIANS

The custodians play a critical role in the secondary market. SEBI (Custodian) Regulation, 1996 was framed for the proper conduct of their business. According to SEBI regulations, custodial services in relation to securities of a client or gold/gold related instrument held by a mutual fund or title deeds of real estate assets held by a real estate mutual fund mean safekeeping of such securities or gold/gold related instruments or title deeds of real estate assets and providing related services.

The related services provided by them are as follows:

- Maintaining accounts of the securities of a client.
- Collecting the benefits /rights accruing to the client in respect of securities.
- Keeping the client informed of the actions taken by the issuer of securities.
- Maintaining and reconciling records of the services as referred above.

Further, every custodian should appoint a compliance officer to monitor the compliance of SEBI Act and its various rules, regulations, and guidelines and for redressal of investor grievances. The compliance officer should immediately report any non-compliance observed by him to the SEBI.

SEBI can also ask for information from the custodian regarding his activities. Such information must be given within a reasonable period as laid down by SEBI. Further, SEBI is also empowered to conduct inspection/investigation including audit of books of account, records etc. of custodians to ensure that they are being properly maintained. SEBI's task is also to ascertain that compliance of provisions of SEBI Act and its regulations have been duly complied with. Moreover, his job is also to investigate complaints received from investors or clients.

7. CLEARING HOUSES

Clearing house is an exchange-associated body charged with the function of ensuring (guaranteeing) the financial integrity of each trade. Orders are cleared by means of the clearing house acting as the buyer to all sellers and the seller to all buyers. Clearing houses provide a range of services related to the guarantee of contracts, clearance and settlement of trades, and management of risk for their members and associated exchanges.

7.1 Role of Clearing Houses

- It ensures adherence to the system and procedures for smooth trading.
- It minimises credit risks by being a counter party to all trades.
- It involves daily accounting of all gains or losses.
- It ensures delivery of payment for assets on the maturity dates for all outstanding contracts.
- It monitors the maintenance of speculation margins.

7.2 Working of Clearing Houses

The clearinghouse acts as the medium of transaction between the buyer and the seller. Every contract between a buyer and a seller is substituted by two contracts so that clearing house becomes the buyer to every seller and the seller to every buyer. In a transaction where P sells futures to R, R is replaced by the clearinghouse and the risk taken by P becomes insignificant. Similarly, the credit risk of R is taken over by the clearing house; thus, the credit risk is now assumed by the clearing house rather than by individuals. The credit risk of the clearing house is then minimised by employing some deposits as collateral by both buyers and sellers. These deposits, known as margins, are levied on each transaction depending upon the volatility of the instrument and adjusted every day for price movements. Margins, which normally are in form of cash or T-bills, can be categorised into the following types: -

- *Initial Margins on Securities:* It is paid by purchasers and short sellers, generally functions as a security for loan, and is like a down payment required for the purchase of a security.
- *Initial Margins on Derivatives:* It refers to funds paid as a guarantee to ensure that the party to the transaction will perform its obligation under the contract. The initial margin on derivatives is designed to cover future changes that may occur in the value.
- *Maintenance Margins:* It refers to the value over and above the initial margin, which must always be maintained in a margin account after the initial margin requirement, if any, is satisfied.
- *Variation Margin:* It refers to funds that are required to be deposited in, or paid out of, a margin account that reflects changes in the value of the relevant instrument.

7.3 Trading Procedure of Clearing Houses

Clients must open an account with a member of the exchange. When they want to trade in futures, they instruct members to execute orders in their account. The trade details are reported to the clearing house. If a member of the exchange is also a member of clearing house, then he directly deposits the margins with the clearing house. If he is not a member, then he should route all transactions through a clearing member to maintain margins.

TEST YOUR KNOWLEDGE

Multiple Choice Questions (MCQs)

1. Which among the following is not an advantage of depository?

   (a) It eliminates bad deliveries of securities.

   (b) The settlement cycle has become quicker. It is now T + 2.

   (c) Immediate transfer and registration of securities are possible now.

   (d) the rate of interest on loan against the pledged demat shares are higher in comparison to physical shares.

2. ……… is known for its growth, liquidity, depth of market and the world's most powerful, forward-looking technologies.

   (a) National Stock Exchange

(b) London Stock Exchange

(c) Nasdaq

(d) New York Stock Exchange

3. ……….. is the person who collects applications on behalf of the investors and keeps a proper record of monies received and paid.

(a) Merchant Bankers

(b) Registrars to an issue and Share Transfer Agents

(c) Underwriters

(d) Bankers to an issue

4. …………. is an investment vehicle where periodic withdrawal from the money invested into the fund is possible.

(a) Hedge Funds

(b) Endowment Funds

(c) Pension Funds

(d) Mutual Funds

5. Which among the following services are not provided by Custodians?

(a) Maintaining accounts of the securities of a client.

(b) Collecting the benefits /rights accruing to the client in respect of securities.

(c) It minimizes credit risk by being a counter party to all trades.

(d) Keeping the client informed of the actions taken by the issuer of securities.

Theoretical Questions

1. Briefly discuss the process of depository system and give a conceptual clarity of what a depository system is.

2. Write a short note on international commodity exchanges.

3. Who is the custodian and what are the services provided by a custodian?

4. Briefly explain the working of clearing houses and their trading procedure?

ANSWERS/SOLUTIONS

Answers to Multiple choice Questions:

1.	(d)	2.	(c)	3.	(b)	4.	(b)	5.	(c)

Answers to Theoretical Questions:

1. Please refer to paragraph 1
2. Please refer to paragraph 2.5
3. Please refer to paragraph 6
4. Please refer to paragraph 7.3