CHAPTER 2

Regulators

2.1 - What is a stock market?

- Investing in equities is an important investment that we make in order to generate inflation beating returns. This was the conclusion we drew from the previous chapter. Having said that, how do we go about investing in equities? Clearly before we dwell further into this topic, it is extremely important to understand the ecosystem in which equities operate.

Just like the way we go to the neighborhood kirana store or a super market to shop for our daily needs, similarly we go to the stock market to shop (read as transact) for equity investments. Stock market is where everyone who wants to transact in shares go to. Transact in simple terms means buying and selling. For all practical purposes, you can't buy/sell shares of a public company like Infosys without transacting through the stock markets.

The main purpose of the stock market is to help you facilitate your transactions. So if you are a buyer of a share, the stock market helps you meet the seller and vice versa.

Now unlike a super market, the stock market does not exist in a brick and mortar form. It exists in electronic form. You access the market electronically from your computer and go about conducting your transactions (buying and selling of shares).

Also, it is important to note that you can access the stock market via a registered intermediary called the stock broker. We will discuss more about the stock brokers at a later point.

There are two main stock exchanges in India that make up the stock markets. They are the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Besides these two exchanges there are a bunch of other regional stock exchanges like Bangalore Stock Exchange, Madras Stock Exchange that are more or less getting phased out and don't really play any meaningful role anymore.

2.2 - Stock Market Participants and the need to regulate them

The stock market attracts individuals and corporations from diverse backgrounds. Anyone who transacts in the stock market is called a market participant. The market participant can be classified into various categories. Some of the categories of market participants are as follows:

1. **Domestic Retail Participants** – These are people like you and me transacting in markets
2. **NRI's and OCI** – These are people of Indian origin but based outside India
3. **Domestic Institutions** – These are large corporate entities based in India. Classic example would be the LIC of India.
4. **Domestic Asset Management Companies (AMC)** – Typical participants in this category would be the mutual fund companies such as SBI Mutual Fund, DSP Black Rock, Fidelity Investments, HDFC AMC etc.
5. **Foreign Institutional Investors** – Non Indian corporate entities. These could be foreign asset management companies, hedge funds and other investors

Now, irrespective of the category of market participant the agenda for everyone is the same – to make profitable transactions. More bluntly put – to make money.

When money is involved, human emotions in the form of greed and fear run high. One can easily fall prey to these emotions and get involved in unfair practices. India has its fair share of such twisted practices, thanks the operations of Harshad Mehta and the like.

Given this, the stock markets need someone who can set the rules of the game (commonly referred to as regulation and compliance) and ensure that people adhere to these regulations and compliance thereby making the markets a level playing field for everyone.

2.3 - The Regulator

In India the stock market regulator is called **The Securities and Exchange board of India** often referred to as SEBI. The objective of SEBI is to promote the development of stock exchanges, protect the interest of retail investors, regulate the activities of market participants and financial intermediaries. In general SEBI ensures…

1. The stock exchanges (BSE and NSE) conducts its business fairly
2. Stock brokers and sub brokers conduct their business fairly
3. Participants don't get involved in unfair practices
4. Corporate's don't use the markets to unduly benefit themselves (Example – Satyam Computers)
5. Small retail investors interest are protected
6. Large investors with huge cash pile should not manipulate the markets
7. Overall development of markets

Given the above objectives it becomes imperative for SEBI to regulate the following entities. All the entities mentioned below in Table 2.1 are directly involved in the stock markets. A malpractice by anyone of the following entities can disrupt what is otherwise a harmonious market in India.

SEBI has prescribed a set of rules and regulation to each one of these entities. The entity should operate within the legal framework as prescribed by SEBI. The specific rules applicable to a specific entity are made available by SEBI on their website. They are published under the 'Legal Framework' section of their site.

Table 2.1 - Regulators in India

Entity	Example of companies	What do they do?	In simpler words
Credit Rating Agency (CRA)	CRISIL, ICRA, CARE	They rate the credit worthiness of corporate and governments	If a corporate or Govt entity wants to avail loan, CRA checks if the entity is worthy of giving a loan
Debenture Trustees	Almost all banks in India	Act as a trustee to corporate debenture	When companies want to raise a loan they can issue debenture against which they promise to pay an interest. These debentures can be subscribed by public. A Debenture Trustee ensures that the debenture obligation is honored
Depositories	NSDL and CDSL	Safekeeping, reporting and settlement of clients securities	Acts like a vault for the shares that you buy. The depositories hold your shares and facilitate exchange of your securities. When you buy shares these shares sit in your Depositary account usually referred to as the DEMAT account. This is maintained electronically by only two companies in India
Depositary Participant (DP)	Most of the banks and few stock brokers	Act as an agent to the two depositories	You cannot directly interact with NSDL or CDSL. You need to liaison with a DP to open and maintain you DEMAT account
Foreign Institutional Investors	Foreign corporate, funds and individuals	Make investments in India	These are foreign entities with an interest to invest in India. They usually transact in large amounts of money, and hence their activity in the markets have an impact in terms of market sentiment

Entity	Example of companies	What do they do?	In simpler words
Merchant Bankers	Karvy, Axis Bank, Edelweiss Capital	Help companies raise money in the primary markets	If a company plans to raise money by floating an IPO, then merchant bankers are the ones who help companies with the IPO process
Asset Management Companies(AMC)	HDFC AMC, Reliance Capital, SBI Capital	Offer Mutual Fund Schemes	An AMC collects money from the public, puts that money in a single account and then invest that money in markets with an objective of making the investments grow and thereby generate wealth to its investors.
Portfolio Managers/ Portfolio Management System (PMS)	Religare Wealth Management, Parag Parikh PMS	Offer PMS schemes	They work similar to a mutual fund except in a PMS you have to invest a minimum of Rs. 25,00,000 however there is no such cap in a mutual fund
Stock Brokers and Sub Brokers	Zerodha, Sharekhan, ICICI Direct	Act as a intermediary between an investor and the stock exchange	Whenever you want to buy or sell shares from the stock exchange you have to do so through registered stock brokers. A sub broker is like an agent to a stock broker

Key takeaways from this chapter

1. Stock market is the place to go to if you want to transact in equities
2. Stock markets exists electronically and can be accessed through a stock broker
3. There are many different kinds of market participants operating in the stock markets
4. Every entity operating in the market has to be regulated and they can operate only within the framework as prescribed by the regulator
5. SEBI is the regulator of the securities market in India. They set the legal frame work and regulate all entities interested in operating in the market.
6. Most importantly you need to remember that SEBI is aware of what you are doing and they can flag you down if you are up to something fishy in the markets!