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## **UNIT 9 STOCK BROKING SERVICES**

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### **Objective**

After reading, this unit you should be able to:

- Describe the basics of the Stock Exchange and its functions
- Comment upon role of the stockbroker.
- Discuss duties and responsibilities of the broker/sub broker.
- Explain the code of conduct of the broker
- Describe duties of the investor.

### **Structure**

- 9.1 Introduction
- 9.2 Stock Exchange and Its Functions
- 9.3 Membership of the Stock Exchange (Stock Broker)
- 9.4 Role of the Member (Stock Broker)
- 9.5 Code of Conduct for the Brokers
- 9.6 The Duties of the Investor
- 9.7 Trading Procedure at the Stock Exchange
- 9.8 Related Institutions and Terminology
- 9.9 Summary
- 9.10 Self-Assessment Questions
- 9.11 Further Readings

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### **9.1 INTRODUCTION**

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The working of the capital market is very technical, and highly sensitive, and hence requires an expert knowledge of the rules and regulations. The stockbroker acts as an important intermediary between the investor, the company, and the stock exchange. The stockbroker is a member of a recognised stock exchange and is engaged in buying, selling, and dealing in various capital market securities. He has to observe the discipline on maintaining adequate capital, registration with SEBI, payment of fees, maintenance of books and records for the investors, and ensure fair play in the dealings. He may or may not appoint a sub broker. A sub broker is also required to be registered with SEBI. The sub-broker cannot enter into direct dealing with stock exchange or other market players. He has to route his transactions through the broker only.

SEBI Stock Brokers Rules and SEBI Stock Brokers Regulations are important enactments, which protect the interests of the investor, the company and the stock exchange. *The Stockbroker or sub-broker who has to*

## **9.2 STOCK EXCHANGE AND ITS FUNCTIONS**

### **What is a stock market?**

A stock market refers to the organised market, where securities are traded. It consists of investors, brokers or members of the stock exchange, stock exchange, companies, and regulatory authority. The securities traded on the stock exchange include various long-term financial instruments, raised by the companies for meeting their financial requirements.

### **Stock Exchange**

The Securities Contracts (Regulations) Act 1956, defines Stock Exchange is an association, organisation or body of individuals, whether incorporated or not established for the purpose of assisting, regulating and controlling business in buying, selling and dealing securities.

A recognised stock exchange is defined as the one, which is recognised by the Government. (S 26 of the Securities Contracts (Regulations) Act 1956.

The Stock Exchanges are regulated by the Securities Contracts (Regulation) Act 1956, and Regulations issued by Securities and Exchange Board of India.

### **Constitution and Organisation of Stock Exchange**

Stock exchange, may be either an association, joint stock company, or company limited by guarantee, as per rules prescribed in the Acts as stated above. It is required to be registered with the Registrar of Companies as a Company. The Government grants recognition, to the stock exchange if the activities are found to be satisfactory and in conformity with the rules/regulations.

It is managed by a Governing Council, a Board of Directors or Management Council. As per SEBI directives, the governing body normally has 13 members of which 6 members are elected, the Central Government or SEBI nominates not more than 3 members. 3 public representatives nominated by SEBI one executive director appointed by Stock Exchange.

Every stock exchange is a link between the general public and corporate bodies interested in raising long-term resources. Hence, it is responsible for.

Maintaining fairness in trading on the stock exchange,

Maintaining discipline in the activities of the members

Maintain transparency and efficiency in operations.

### **Functions of Stock Exchange**

1. Provide ready market for securities,

2. Provide negotiability to transactions of sale and purchase,
3. Provide liquidity to security,
4. Channel for distribution of new securities through network of members,
5. Help the capital formation process,
6. Direct the flow of resources to successful enterprises.

Stock exchanges are the important constituent of the Capital Market. Well-regulated and smoothly functioning stock exchange is an indicator of the developed capital market.

Stock exchange transactions can be made only through the member.

### **Activity 1**

How many stock exchanges are currently functioning in India. Find out the statistical details of any 4 of them for the last 3 years.

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### **9.3 MEMBERSHIP OF THE STOCK EXCHANGE (STOCK BROKER)**

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Membership is granted to only those persons who are financially sound and possess adequate expertise and experience. The member of a stock exchange is also required to be registered with Securities and Exchange Board of India (SERI) Membership to the stock exchange and SEBI is obtained only after payment of certain fees. The members act as custodians for the securities of the investors who entrust them to sell/purchase as the case may be.

The members or Stockbrokers normally perform the under-mentioned functions, either directly or through sub-brokers to act as commission broker, floor broker, jobber, dealer in securities, dealer in Govt. securities, underwriters.

The Brokers on stock exchange normally perform the following functions:

1. Investment/speculative broking for individual investors
2. Trading on-account
3. Arbitrage
4. Up country business on brokerage basis
5. Primary market fund mobilisation

6. Management of portfolio of investment of individuals/bodies
7. Placement of shares with Foreign Institutional Investors, mutual funds
8. Institutional broking
9. Inter corporate broking of funds
10. Mergers acquisitions, and amalgamations
11. Forex services
12. Borrowing through commercial paper

**The relationship** between the stockbroker and the investor involves great deal of trust, and is governed by Stock exchange bye-laws, SEBI rules and regulations. The broker is indemnified by the client. He has a lien on the property of the client for payment of amount due as margin money, brokerage, interest and other expenses.

### **Corporate Membership to Stock Exchange**

In order to get corporate membership to the Stock Exchange, a Company should fulfill the following norms

1. **Net Worth norms:** A Company seeking admission as a corporate member of any stock exchange shall have a minimum net worth as specified by particular exchange. This will also depend upon the segment in which corporate member wish to operate. The basis of fixing the minimum paid up capital norm is as per the formula prescribed by Dr. L.C. Gupta Committee.
2. **Capital adequacy norms:** The Company should maintain capital according to the capital adequacy norms specified by SEBI.
3. **Additional financial and other requirements:** Stock exchange may specify other financial requirements, which are binding on the corporate member, which will have to be fulfilled by the company.
4. **Multiple memberships:** Where a corporate member desires to have membership of more than one stock exchange then the company should fulfill the conditions mentioned in 1, 2, and 3 above, separately for each stock exchange and maintain separate accounts for the same.
5. **Collection of deposits:** The rules as applicable to Non banking financial companies will apply in respect of collection of deposits from public, not being margin money from investors,
6. **Directors on the board of such company:** Individuals, who have been penalised by cancellation of their registration, as intermediaries are not allowed to be on the board of directors of the companies.

## **9.4    ROLE OF THE MEMBER (STOCK BROKER)**

The Stock Broker means the Member of Stock Exchange.

**Sub-Broker** means any person not being a member of a stock exchange who acts on behalf of a stock broker as an agent or otherwise for assisting the investors in buying/elling or dealing in securities through stock brokers.

Stock-brokers and sub-brokers are governed by the Rules and Regulations, issued by SEBI in this context.

### **Registration with SEBI Compulsory**

A stockbroker or sub broker cannot buy/sell/ or deal in securities unless he holds a certificate from SEBI, or at least has applied for obtaining such a certificate. He is required to pay required fees to SEBI for keeping the registration in force.

## **9.5    CODE OF CONDUCT FOR STOCK BROKERS**

The role of a stock broker or sub broker is defined in the **Code of Conduct for Stock Brokers** in, Schedule II of Regulation 7 of the SEBI Stock brokers and sub brokers Regulations 1992. (See Annexure 1 to this unit).

The relationship between the investor and the stock broker is based on utmost mutual trust and faith. In addition, it is obligatory on the part of the investor as well as the broker to perform the business with utmost care and honesty, maintaining high levels of secrecy, integrity and clarity in the transactions.

A stock broker is required to perform his duty with integrity, high standards of fairness, and promptitude in all his dealings. He is required to exercise skill, care, and diligence in the conduct of his business. He should not indulge in any manipulative, fraudulent or deceptive transactions or schemes or spread rumors with a view to distorting market equilibrium or making personal gains. A stockbroker shall not either create false market singly or in concert with others or indulge in any act detrimental to the investor's interest or which leads to interference with the fair and smooth functioning of the market. A stock broker shall not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness.

**Duties to the Investor:** The stockbroker shall issue to his client, a contract note, for all the transactions, in a form specified by the stock exchange.

The stock broker should disclose to the client whether he is acting as a principal or as an agent and shall ensure that no conflict of interest arises between him and the client. In such an event of conflict, he shall inform to the client accordingly and shall not seek to gain a direct or indirect personal benefit from the situation and shall not consider clients' interest inferior to

his own, maintain accounts of the investment transactions, give account to the client of the securities and their disposal, and make payments of money due to the client. The broker must deliver securities acquired within 2 working days of payout unless the client has requested otherwise.

Stock broker shall not make a recommendation to any client who might be expected to rely thereon to acquire, dispose of, retain any securities unless he has reasonable grounds for believing that the recommendation is suitable for such a client upon the basis of the fact, if disclosed by such a client as to his own security holding, financial situation and objectives of such investment.

## **9.6 THE DUTIES OF THE INVESTOR**

The investor is also required to complete all the transactions as per contract. He is required to pay the necessary brokerage, commission etc due, to the stock broker and be responsible for his own decision of purchase, sale or dealing in the security. He is required to pay at least 20% of the price of securities ordered to be purchased, to the broker, as margin for all the orders for purchase of securities. An investor is required to furnish full details about his name, address, status of employment or business, name of the banker, and bank account number through which operations are to be done, and other such details to the broker. He should also give proper introduction to the broker, and permanent income tax account number, in case of transactions for more than Rs. 1 lakh.

### **Activity 2**

Obtain the issue prospectus of at least five companies, and as an ordinary investor give reasons for investing or non-investing Rs 1 lakh in each of these issues in India.

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## **9.7 TRADING PROCEDURE AT THE STOCK EXCHANGE**

### **The normal procedure**

- a) The client places an order with his broker/sub broker, for purchase/sale of a specified security within the specified range of price.
- b) Broker executes the order, i.e. completes the deal for either purchase or sale of the specified number of security instruments through another

broker.

- c) The brokers prepare the contract note.
- d) Delivery of shares by broker/client, against the bill or delivery note.
- e) Payment against the delivery note.

#### **Types of delivery of securities**

- a) **Spot delivery:** delivery of security and payment is made on the day of contract or on the next day.
- b) **Hand Delivery:** delivery and payment should be made within 14 days of contract date. This period may be extended by Stock Exchange, in slots of 14 days at a time, up to a maximum of 90 days.
- c) **Special delivery:** is completed beyond the period of 14 days, and is permitted by Board or President of Stock Exchange.

**Delivery** of scrip is said to be completed when a seller of a security (scrip) delivers the scrip along with transfer deed signed by the transferor and duly witnessed, to the buyer member, and the buyer members takes the scrip and the certificate.

The broker is expected to see that the delivery is good. This means that the security certificate should not be fake, forged or mutilated, and must be properly signed by the transferor as per his specimen signature. The broker should be fully aware of the SEBI guidelines about good and bad deliveries, and ensure that the delivery is not bad.

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## **9.8 RELATED INSTITUTIONS AND TERMINOLOGY**

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**OTCEI:** Over the counter exchange of India is a limited Co. and acts an exchange without a specified trading floor. It does not have a market place physically and the market is spread across the country through counters. All the counters are connected. Through network of computers and transactions, take place through satellite communication. The authorised share capital of 10 crores is held by UTI, ICICI, IDBI, IFCI, LIC GIC, SBI Capital Markets Ltd., Can bank Financial Services Ltd.

**NSE:** National Stock Exchange: It was incorporated as per the recommendations of Pherwani committee on establishment of a powerful stock exchange. The NSE is established in Mumbai, and provides three-tier structure consisting of principal stock exchange, regional stock exchange and additional trading floors sponsored by a stock exchange. It provides support to

- 1) National Clearing and Settlement Corporation to administer the clearing and settlement of securities and
- 2) Central Depository Trust and securities facilities support corporation for

network between exchanges. It provides satellite based fully automated screen based trading, transparency to transactions, regional spread. It operates wholesale debt market segment, capital market segment, and derivatives market segment

**Arbitrage:** The purchase or sale of securities so as to profit from by reversing the transaction through the price differential, with respect to stock exchange (place), or time.

**Asking price:** The lowest price at which the stockholder is willing to sell the scrip.

**Bid:** An offer of a price one is willing to pay for buying the security.

**Brokerage:** Commission (as per rates stipulated by stock exchange Byelaws) payable to the stockbroker for services rendered by him in respect of purchase/sale of the desired scrips.

**Closing out:** When a party to contract does not fulfill delivery against sale or payment against delivery of documents, the other party closes out the transaction, through the medium of stock exchange. The loss or gain is borne out by the defaulter.

**Contract note:** Is written evidence given by the member of the stock exchange to the client giving out details of the number of shares to be bought or sold rate of the price and date of conclusion.

**Depository:** Is an organisation where the securities of a share holder are held in the electronic form at his request. This helps the share holder in quick disposal of the security for liquidity and profit making, through the depository.

### Activity 3

What do you understand by BSE and NSE? Which are the international equivalents of these terms?

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## 9.9 SUMMARY

A stockbroker must be a member of a Stock Exchange, and should hold the necessary certificate from SEBI, for dealing with the securities because of the

investor's .He has to provide high standards of service to the investors, the stock exchange and the SEBI. He is required to maintain the books of accounts and necessary record. He should fulfill the general obligations such as payment of fees to SEBI, and abide by the code of specified, allow the records and transactions to be inspected by the SEBI/Stock exchange authorities. He must ensure fair play. The investor on the other hand should not be carried away by the advice of the broker, and should take his prudent judgement.

## **9.10 SELF-ASSESSMENT QUESTIONS**

1. What are the functions of Stock Exchanges?
2. State whether true or false:
  - a) A stockbroker is required to be registered with SEBI as well as Stock Exchange for doing business.
  - b) In a spot delivery contract of sale of securities the delivery of the security and payment thereof are made after 48 hours.
  - c) In a special delivery of securities SEBI permission is necessary.
3. Which books of accounts and records are compulsorily required to be maintained by the Stock Broker?
4. Write three acts of the Stock broker, which may result in, to the award of punishment of suspension of registration by SEBI
5. Find out the meaning of the under mentioned terms used in Stock Exchange Markets in India
  - a) Bear, Bull, Premium, at par
  - b) Bottom Line
  - c) Blank Transfer
  - d) Bad delivery, and good delivery
  - e) Call money, notice money
  - f) Open ended and Close ended schemes
  - g) Marking of a security to market, and current yield
  - h) Earnings per share
  - i) Stock
  - j) Junk bond
  - k) Listed shares
  - l) Mhurat trading
  - m) Derivatives in capital market
  - n) Over bought, oversold and square position of the broker
  - o) Quote for a security

## **9.11 FURTHER READINGS**

1. Merchant Banking: Dr JC Verma, Bharat Law House P Ltd, Delhi.
2. Indian Capital Market, Sanjiv Agrawal, Bharat Law House P Ltd, Delhi.
3. A Practical Hand Book to Public Issues and Euro Issues, V I Iyer, Taxman Allied Services (p) Ltd.
4. SEBI Capital Issues and Listing, Bharat Publishing House.
5. The Manual/guidelines on Investment Management issued by the commercial banks individually.



