KNOW ABOUT STOCK EXCHANGE

What is a Stock Exchange?
A common platform where buyers and sellers come together to transact in stocks and shares. It may be a physical entity where brokers trade on a physical trading floor via an "open outcry" system or a virtual environment.

What is electronic trading? Electronic trading eliminates the need for physical trading floors. Brokers can trade from their offices, using fully automated screen-based processes. Their workstations are connected to a Stock Exchange's central computer via satellite using Very Small Aperture Terminus (VSATs). The orders placed by brokers reach the Exchange's central computer and are matched electronically.

H**ow many Exchanges are there in India?**The Stock Exchange, Mumbai (BSE) and the National Stock Exchange (NSE) are the country's two leading Exchanges. There are 20 other regional Exchanges, connected via the Inter-Connected Stock Exchange (ICSE). The BSE and NSE allow nationwide trading via their VSAT systems.

Stock Exchange is a place where the buyers and sellers meet to trade in shares in an organized manner. There are at present 25 recognized stock exchanges in the country and are governed by the Securities Contracts (Regulation) Act, 1956.

The functions of the stock exchange are as follows:

1) The stock exchange ensures a measure of safety and fair dealing in shares.

2) It translates short-term and medium term investments into long-term funds for companies.

3) It directs the flow of capital to the area of maximum returns and ensures ample investment options for the investors depending on their risk preference.

4) It induces the companies to raise their standards of performance.

· National Stock Exchange

The National Stock Exchange (NSE) set up as a public limited company, is owned by the leading institutions of the country. Industrial and Development Bank of India (IDBI) is a major shareholder of NSE.

The ownership and management of the Exchange is completely separated from the right to trading members, to trade on the NSE. The Exchange is managed by a Board of Directors. Decisions relating to market operations are delegated by the Board to an Executive Committee, which includes representatives from Trading Members, public and the management.

The NSE has an automated order driven trading system. Member workstations are spreadout throughout the country and NSE′s network is one of the largest interactive VSAT based network. The NSE in its endeavour to provide transparency provides live quotes of all traded securities through its web site.

Who can trade in the Secondary Market?

· Share Brokers/Sub Brokers

A stockbroker is a member of a recognized stock exchange. No stockbroker is allowed to buy, sell or deal in securities, unless he or she holds a certificate granted by SEBI.

A stockbroker applies for registration to SEBI through a stock exchange or stock exchanges of which he or she is admitted as a member. A stockbroker may take the form of sole proprietorship, partnership or corporation.

Sub-broker is a person who intermediates between investors and trading members. Stockbrokers of Indian stock exchanges are permitted to transact with sub-brokers.

Capital Adequacy Norms For Brokers

Each stockbroker is subject to capital adequacy requirements consisting of two components:

1. Base minimum capital, and

2. Additional or optional capital related to volume of business.

The amount of base minimum capital varies from exchange to exchange. The form in which the base minimum capital has to be maintained is also stipulated by SEBI. Exchange may stipulate higher levels of base minimum capital at their discretion.

. How to register as a client?
Details to be furnished

Agreements with Clients

The Trading Member shall enter into an agreement in the specified format provided by NSE with the client before accepting orders on latter's behalf. The said agreement shall be executed on Non-Judicial Stamp Paper, duly signed by both the parties on all the pages. In Maharashtra, Non-Judicial Stamp Paper of Rs. 20 is required for the said agreement. Copy of the said agreement is to be kept permanently.

In addition to the Agreement, the Trading Member shall seek information from the client in the 'Client Registration Application Form' obtaining information like: investor risk profile, financial profile, social profile, investor identification details, family, income, employment, age, investments, other assets, financial liabilities, other responsibilities, social standing, investments horizon, risk taking ability etc. The Trading Member shall obtain recent passport size photographs (three copies) of each of their clients in case of individual clients and of all partners in case of partnership firms and of the dominant promoter in case of corporate clients. The Trading Member shall also take proof of identification of the client.

A stockbroker shall not deal knowingly, directly or indirectly, with a client who defaults to another stockbroker.

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There is no limit on maximum number of clients for a trading member.

Margins From the Clients

SEBI has made it mandatory for the Trading Member to collect margins from clients in all cases where the margin in respect of the client in the settlement, would work out to be more than Rs.50,000/-. The margin so collected shall be kept separately in the client bank account and utilised for making payment to the clearing house for margin and settlement with respect to that client.

Execution of Orders

The Trading Member (Broker) shall ensure that appropriate confirmed order instructions are obtained from the clients before placement of an order on the system. In order to execute a trade for a client, a broker must have specific customer instructions as to name of the company, the precise number of shares and limit/market price condition.

He shall keep relevant records or documents of the same and of the completion or otherwise of these orders thereof.

Where the client requires an order to be placed or any of his order to be modified after the order has been entered in the system but has not been traded, the Trading Member shall ensure that he obtains order placement/modification details in writing from the client.

The Trading Member shall make available to his client the order number and copies of the order confirmation slip / modification slip / cancellation slip and a copy of the trade confirmation slip as generated on the Trading System, forthwith on execution of the trade.

The Trading Member shall maintain copies of all instructions in writing from clients including Participants for an order placement, order modification, order cancellation, trade cancellation etc.

Contract Notes

A Stock-broker shall issue a contract note to his clients for trades (purchase/sale of securities) executed with all relevant details as required therein to be filled in. A contract note shall be issued to a client within 24 hours of the execution of the contract duly signed by the Trading Member or his Authorized Signatory or Client Attorney.

No member of a recognised stock exchange shall in respect of any securities enter into any contract as a principal with any person other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal.

The Trading Member is required to maintain the duplicate copy of the contract notes issued for five years.

The Trading Member shall ensure that -

a)Contract Notes are to be in the prescribed format,

b)Maintain details in the counterfoils of contract notes,

c)Stamp duty is paid,

d)The service tax charged in the bill is shown in the contract note, and

e)Contract notes are signed by the authorised signatory.

It is a statement confirming the trades executed on a given day for and on behalf of the client and it is issued in a format specified by the regulatory authorities. It gives details such as order number, time, trade number, executed time, quantity, rate at which the transaction took place, brokerage charged by the broker, rate inclusive of the brokerage, service tax payable on the transaction etc.,

The Contract Note is sent to the client within 24 hours of the execution of the trade.

Is it necessary to get a Contract Note from the Broker? What is the importance of a Contract Note?

It is very much necessary to get a contract note from your broker. Besides confirming your transactions, it serves as an exhibit when you have a grievance with your broker regarding under performance or non-performance of the obligations mentioned thereof.

Traders' Mechanisms

- Execution of Orders
- Price Determination under Market conditions
- Outcry System

A trading system in which all the Members and/or their authorised representatives used to

assemble at the trading floor of the respective stock exchanges. Trades were executed on the buyers and sellers orally indicating their interests in a counter.

· Screen Based Trading

The central computer located at the Exchange is connected to the workstations of the Brokers through satellite using Very Small Aperture Terminals (VSATs). Orders placed at the Brokers' workstations reach the central computer and are matched by the computer based on price and time priority.

Now let us discuss briefly the facilities that are available on the Trading Screen.

Information on a Company's performance

You can view information regarding a company's performance on screen. The company profile is updated on a regular basis by the Exchange to the benefit of investors.

Modify or Cancel an Order

The order placed earlier can be modified or cancelled provided it has not been executed till then.

Trade Cancellation- is it possible?

Trade cancellation normally is not possible. However, one can send a request to the

Exchange to that effect. The Exchange will then try out the possibility and revert back.

Stop Loss Order

Everyone trades in the market to make a profit and it is not always possible to square off a trade with a surplus. A client can atleast minimise his losses if he can resort to using this 'stop loss′ order option.

A stop loss order is one, which is placed with a 'trigger price' and is placed to minimise the losses and the order can be either for a purchase or a sale. A stop loss buy/sell order is keyed in to cover a sale/purchase made earlier in the day.

Now with regard to the Stop Loss Orders, certain attributes are to be understood.

'Trigger Price' and the way a stop loss order works

The Trigger Price is one, which is entered by the client when he places a stop loss order. As said earlier, a client in order to minimise his loss, places a stop loss buy order against his earlier sale. For example, if he has short sold a scrip at Rs. 125, he wants to ensure his loss is minimised. He may willing to afford a loss of, say, Rs.10/- per share. In these circumstances, he places a stop loss buy order (a limit order) at Rs.135/- and sets a trigger price of Rs. 132/-. The trigger price must be between the last traded price and the limit buy order price. Once, the price of the scrip breaks this trigger price barrier, the 'stop loss' attribute is removed and the order gets converted into a limit buy order at Rs.135/-.

In the same way, the stop loss trigger price has to be between the last traded price and the limit sell order, when he is trying to minimise his loss on his purchase position.

'Disclosed Quantity'

An order can be entered in the system wherein only a fraction of the order quantity is disclosed to the market. For example, if the order is for 1000 shares and the disclosed quantity is 200 shares, then only 200 is disclosed to the market. Once this gets executed, a subsequent quantity of 200 is disclosed and so on.

Off line Order entries It is possible to place orders even after the market is closed. The order will be stored in the system and be routed to the market when it opens again the following day.

Delivery Based trading

When you want to buy or sell a share for the purpose of receiving or effecting deliveries, it means you are doing a delivery-based transaction.

Square off trade

When you close out your position (purchase or sale) taken earlier in the settlement, it is said you have squared off your transaction. Only the net difference is payable or receivable by you.

Margin Trading

Normally when you want to buy a share on a delivery basis, you are required to bring in the entire amount as upfront. But when you want to do margin trading, all you have to do is pay, say for example 25% to 33% of the exposure you want to take. Which means, to have an exposure limit of Rs.1,00,000/-, you will have to pay a margin deposit of Rs. 25,000/- or Rs.33,000/- depending upon the broker with whom you are dealing.

Leverage Effect under Margin Trading

The Brokers normally allow the customers an exposure limit of 3 to 5 times of the margin money brought in by the customers. This ability to control a large monetary amount with correspondingly small amount of capital is the leverage effect one gets in margin trading concept.

Exposures and Settlements Wednesday, 20 November , 2002, 16:30
Last Updated: Wednesday, 20 November , 2002, 17:47

Gross Exposure/Net Exposure

- What is Exposure Limit? How is it fixed?

The Exposure Limit is the maximum value of open positions a customer is allowed to have at any point of time during a settlement. This is fixed based on the margin amount paid by the customer.

- What is Gross Exposure? What is Net Exposure?

The total value of all open positions (both purchases and sales) held by the customer at any point of time during the settlement is known as the Gross Exposure. The total value of all his purchases minus the value of his sales at any point of time during the settlement is known as his net exposure.

- Different Types of Margin
- Calculation of Margins
- How and When Margins are paid?
- Release of Margin
- Transfer of Funds and Documents
- Pay In and Pay Out of Funds and Securities
- What is Payment Gateway Interface?
- Physical and Demat Deliveries
- Good / Bad Deliveries
- Corporate Benefits

Entitlement to Corporate Benefits

What is a Rolling Settlement?

It is an account period for transactions where settlement is made on the third working day after the trading day (T+3). On the T+3rd day pay-in and pay-out of both funds and deliveries take place at the clearing corporation of the stock exchange.

Payments and Deliveries

Pay-in and Pay-out

A Pay-in day is the designated day on which funds and securities are transferred by the Trading Member to the National Securities Clearing Corporation Limited (NSCCL), the clearing house of the National Stock Exchange.

A Pay-out day is the designated day on which funds and securities are transferred to the Broker's account by the NSCCL.

At present, in the Rolling Settlement (where the settlement is on a daily basis), Pay-in and Pay-out are scheduled on the T+3rd day, where T stands for the trading day and +3 denotes the third working day following the trading day.

When and how should payment be made?

You are required to pay the entire amount towards your purchases before placing the order in case you are making a delivery-based transaction. You have to assign the required funds to the Broker' s account if you have the account in the same bank as that of the broker. In the event of your having an account in a different bank, the cheque or pay order issued by you should get credited to the broker's account before a purchase order is placed.

If you are doing margin trading, then the required margin money should already be lying with the broker's account.

When and how should scrips be delivered or transferred?

The scrips you intend to sell should be transferred to the Broker's DP account prior to your placing the sale order. Or you may place a sale order for a scrip which had been earlier purchased by you and lying with the Broker in his DP account.

Sale proceeds

The broker will make payment to you against your sales, subject to your timely delivery/transfer of the scrips sold, to his DP account. The payment will be made to you within 48 hours of the broker getting the pay-out from the Exchange. However, the broker may hold back your payment in the event of your taking a fresh position meanwhile.

Delivery of Scrips

Subject to your effecting full payment towards your purchase obligation, the securities will be transferred to your DP account within 48 hours of the broker receiving the pay-out of deliveries from the exchange. The Broker may hold back the securities for reasons such as requirement of additional margin payable by you or the securities having been sold by you in the meantime.

The Auction House Wednesday, 20 November , 2002, 16:31
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What is an Auction?

A mechanism used by the Stock Exchange to fulfill its obligation to the buyer of a security. It is done when the seller is unable to deliver the scrips sold by him. The security in question is offered by a member who has ready possession of the scrips.

The securities are put up for auction by the Exchange on account of non-delivery of securities by the selling trading member to ensure that the buying trading member receives the securities due to him. The non-delivery by the trading member could arise on account of short delivery, bad deliveries not rectified and company objections not rectified by them.

The Exchange purchases the requisite quantity in the Auction Market and gives them to the buying trading member.

Can I take part in the Auction Market?

Yes, you can take part the Auction Market provided your Broker allows you to do that. Still you must ensure that the shares you want to offer are readily available for delivery because, they have to be transferred to the Clearing Corporation within a day.

You also should be aware of the fact that securities not delivered on auction pay-in day or bad delivery of securities delivered in auction are directly squared off at a price specified by the Exchange/Clearing Corporation.

Is there any possibility of the share not being offered in Auction? What happens in that case?

At times there is a possibility of the shares not being available in the Auction market. In such cases, the transaction is squared up as per SEBI guidelines which states that the transaction shall be squared up at the highest price on the NSE from the relevant trading period till the close-out day or at 20% above the last available trading price on the NSE, whichever is higher

The Clearing House Wednesday, 20 November , 2002, 16:35
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Role of Clearing Corporations

· · Depository

NSDL is India's first depository. Depository is an entity that converts physical share certificates into electronic form. This eliminates the need to deliver physical certificates on sale and transfer all exchange and transfer takes place in the electronic form. All settlement activity takes place through the Depository. An investor is required to open accounts with Depository Participants (DP) who are members of the NSDL. Investors can open as many accounts as they wish to open. They have to present their physical certificates to the DP to be converted to electronic form. The DP sends the shares to the company/ transfer agent who destroys the physical certificates and equivalent number of securities are credited to the investors account. This process is called dematerialisation. An investor can dematerialise his entire depository eligible securities through the same account provided all of them have the same holding pattern of names. Once the shares are dematerialised, they can be traded through any member of a stock exchange by giving details of his account with the DP.

Depository trades are done in account period settlement and rolling settlement. SEBI has notified certain securities to be in compulsory demat form. For such securities, investors have the option to settle in rolling or account period settlement. However, all other demat securities are to be settled in rolling settlement, that is on T+5 day.

An investor also has the option to apply to the company to rematerialise his shares. Rematerialisation means converting shares held in electronic form back to physical certificates.

· · Depository Participants

Depository Participants are agents of the depository. They are the intermediaries between the depository and the investors. The relationship between the DPs and the depository is governed by an agreement made between the two under the Depositories Act. In a strictly

legal sense, a DP is an entity that is registered as such with SEBI under the provisions of the SEBI Act. As per the provisions of this Act, a DP can offer depository-related services only after obtaining a certificate of registration from SEBI.

· · Clearing member

The entities that are authorised to pay in and receive the pay out from a clearing corporation/clearing house against trades done by them or their clients are known as clearing members (CMs). CMs are identified in the system through their CM-BP ID. All pay-in and pay-out transactions are carried out through their accounts.

There are two types of clearing members:

1. All members of a stock exchange popularly known as brokers are clearing members;

2. Custodians who are permitted by the stock exchange to act as a clearing member.

Every broker in a stock exchange offering settlement in dematerialised securities opens a distinct account called 'clearing member account'. It is identified with a number called 'CM-BP-ID' (Clearing Member-Business Partner Id). If a broker deals in more than one stock exchange, he is allotted one CM-BP-ID per stock exchange. The DI slip should contain the CM-BP-ID relevant to the stock exchange in which the trade was done.

· · Pool Account

A Demat account maintained by the Trading Member with a Depository Participant affiliated to either to the National Securities Depository Limited or Central Depository Services Limited as prescribed by the concerned Stock Exchange with whom he is registered as a Member. The securities sold by the clients of the Trading Member are transferred from their DP account to the Pool Account the Trading Member who in turn instructs them to be transferred to the Clearing Corporation through the Depository (NSDL or CDSL). In the same manner, the securities bought by his clients are transferred to the Trading Member's Pool Account by the Clearing Corporation on the Pay-out day.

· · Beneficiary Account

This is an account opened by investors to hold their securities in dematerialised form with a depository and to settle the transactions of sale and purchase of such securities in book-entry form through the depository system. An account holder is legally entitled for all rights and liabilities attached to the securities (i.e., equity shares, debentures, government securities, etc.) held in that account. Therefore, the account is called "beneficial owner account" also. A beneficiary account can be in the name of an individual/corporate or the broker himself for the purpose of his personal investments in demat form. The account is opened with a DP.

House account - An account opened by a DP for the custody of and transactions in its own investments is referred to as a house account, and all other beneficiary accounts are referred to as non-house accounts. DPs are required to open house accounts for their transactions to prevent co-mingling of their securities investments with the investments of their clients.

· · Who can open a Beneficiary Account?

Neither the Depositories Act, 1996 nor the Regulations made under the Act lay down any specifications about who can open a beneficiary account. Since all beneficial owners are deemed to be members of a company (under section 41(3) of the Companies Act, 1956), only those who are eligible to become members of a company under the Companies Act, 1956 can open a beneficiary account with a depository. Thus, all legal entities with the exception of partnership firms can open an account in the depository system.

FAQ's ON ROLLING SETTLEMENTS

What is the Rolling Settlement?

What is the status of Indian Capital Markets in terms of Rolling Settlements of trades?

What is the pay-in and pay-out schedule for scrips under CRS on T+3?

Why we need Rolling Settlements?

What do you mean by T+5, or T + 3.... What is 3 or 5?

What are the advantages of Rolling Settlements compared to weekly settlements?

Can one square off transactions done in Rolling Settlements?

How can one prepare himself for Rolling Settlement?

What is Trade to Trade in the Rolling Settlements?

Why BSE has included the scrips under Trade to Trade to "Z" group ?.

What about scrips where trading and settlement takes place on Trade to Trade basis because of Surveillance reasons?

An investor holds shares of the company XYZ Ltd. The company has been included in "Z" group for not making demat arrangements. When the scrip of XYZ Ltd. would be shifted back from "Z" group?

I am holding shares of XYZ Ltd., which has been included in "Z" group for not making demat arrangements. Whether, the company would be shifted out of "Z" group as soon as the company makes demat arrangements. Under what conditions the company would remain in "Z" group notwithstanding demat arrangements?.

Can one deliver the shares in the physical form where only demat deliveries are permitted?

How to identify the scrips which are settled with compulsory demat delivery in the Rolling Settlements?

What is the margining system in Rolling Settlements?

What is the circuit filters system applicable for scrips traded in Compulsory Rolling Settlements?

An investor has sold shares in the CRS scrip for delivery, can he avoid paying VaR/Mark to Market losses?

What happens if one fails to submit shares sold?

What happens if one buys shares on one day and sells the same on the following day and does not get delivery of shares purchased?

How is the No-delivery fixed in Rolling Settlement?

What would happen in the scenario when the No- Delivery is abolished?

Can one take advantage of price differential prevailing on two Exchanges in the Rolling Settlement?

1.Q. What is the Rolling Settlement?

A. Rolling Settlement is a mechanism of settling trades done on a Stock Exchange on T, i.e., trade day plus "X" trading days, where "X" could be 1,2,3,4 or 5 days. In other words, in T

+5 environments trades done on T day are settled on 5th working day excluding the T day. In India, until recently, the settlement of majority of trades was done on Account Period basis, where trades done in a trading cycle of 5 days were consolidated, scrip-wise netted and settlement of such netted trades took place on a single day in the following week. Thus, it took anywhere between one to two weeks for the investor depending upon the day of his transaction to realize the money for shares sold or get delivery of securities purchased. However, in the Rolling Settlements, trades done on each single day are settled separately from the trades done on earlier or subsequent trading days. The netting of trades is done only for the day and not for multiple days. In our markets, the trades in Rolling Settlements, to begin, with were settled after 5 trading days from the day of trading and w.e.f. April 1, 2002, the trades in all the scrips listed and traded on the Exchange are now settled on T+3 basis. However, the investors are advised to check with their broker about the exact date of settlement, as deviations are possible on account of intervening holidays etc.

2.Q. What is the status of Indian Capital Markets in terms of Rolling Settlements of trades?

A.The Indian stock markets until recently were largely operating on Account Period basis, where transactions done during a week were netted and settled on a pre- specified date in a batch mode in the following week. The capital markets world over were settling the trades in scrips on Rolling basis as per the recommendations of Group of 30(G 30) (A group to identify the best international practices of securities clearing and settlements). Securities and Exchange Board of India (SEBI)- the market regulator in India, has gradually mandated that certain scrips would be settled exclusively on Rolling Settlement basis. This commenced in January 2000. Till June 2001, trading in a small number of scrips of small and mid cap companies had been shifted to Compulsory Rolling Settlement (CRS). However, w.e.f. July 2, 2001, SEBI mandated CRS in all large cap companies (mostly forming part of BSE- 200 Index and the scrips having a facility of deferral of the trading positions) on T+5 basis. Further, w.e. f., December 31, 2001, trading and settlement in all listed securities have been mandated under CRS on T+5 basis and Weekly or Account period settlement has been discontinued. With effect from April 1, 2002, trades are settled on T+3 basis as against T+5 earlier.

3.Q. What is the pay-in and pay-out schedule for scrips under CRS on T+3?

A. The transactions in the scrips in CRS are settled on T+3 basis, i.e., both pay- in and pay- out of monies and securities for transactions on T day takes place on the same day, i.e., on T+3. With this, Indian exchanges have achieved settlements on Delivery v/s Payment (DvP) basis at the Exchange-member level.

4.Q. Why we need Rolling Settlements?

A. Internationally, the Rolling Settlements have been accepted as the best method of settling trades. G 30 way back in 1989 had recommended that settlement of trades at Stock Exchanges should take place on T+5 on Rolling Settlement basis and subsequently the same should be done on T+3 basis. Therefore, Rolling Settlements in any capital markets represent the best international practice.

5.Q. What do you mean by T+5, or T + 3.... What is 3 or 5?

A. In Rolling Settlements, 3 or 5 denotes after how many trading days the trades done on T day will be settled by payment of monies and delivery of securities.

6.Q. What are the advantages of Rolling Settlements compared to weekly settlements?

A. Since, in the Rolling Settlements, the trades are settled earlier than in account period settlement, the settlement risk is lower. The reason for this could be that in weekly settlements, the cumulative position built up over various days was consolidated, netted and settled on a single day. This resulted in higher deliveries to be settled for the trades done during the week. Since in Rolling Settlements, trades on a particular day are settled separately from the trades done on any other days, the settlement risk is considerably reduced. Moreover, the sellers

and buyers get the monies and securities for their sale and purchase transactions, respectively earlier than in Account Period settlements. This also achieves international best practice for settling trades.

7.Q. Can one square off transactions done in Rolling Settlements?

A. Yes, since the trades done during a day in a Rolling Settlement except those in scrips in "Z" group are netted, one can square off the transaction on that day only. The trades in "Z" group scrips are not allowed to be netted and are settled on a trade to trade basis. As such, the squaring off should be done before close of the market hours on that day. It may be clearly understood that the trades during a day cannot be squared off or netted with transactions on the earlier or subsequent days.

8.Q. How can one prepare himself for Rolling Settlement?

A. As discussed earlier, the settlement of trades in all listed securities is done in Rolling Settlements on T+3 basis, where the settlement period has considerably reduced. It is, therefore, necessary for the investors to fully acquaint themselves with the dynamics of the new systems. In respect of those securities which can only be delivered in demat mode, it is imperative for the investors to get their holdings in the physical form in these scrips converted in the demat form. Further, since the movement of funds and securities need to be very fast in Rolling Settlements, the investors should assess the Depository Participant and banking infrastructure available at their location. The investors are advised to move their shares from their Beneficiary Owner A/c with DPs to the broker's pool account at the earliest after the sale transactions are done. Further, the physical shares (in case of the settlement of trades in the securities where delivery in physical form is permitted) should be sent to the broker at the earliest after sale order has been executed. Similarly, the investors should arrange for remittance of funds to their broker sufficiently in time, after he has executed a purchase transaction on their behalf, so as to enable the latter to meet the pay-in deadline. Timely receipt of funds and securities from the investors by the brokers ensures that they are able to meet their settlement obligation relating to money and securities with the exchange on time.

9.Q. What is Trade to Trade in the Rolling Settlements?

A. SEBI has mandated that trading and settlement in all listed securities on the Exchanges would take place only in CRS. Further, it had directed all the companies to sign agreements and establish connectivity with both the Depositories latest by September 30, 2001. SEBI has further mandated that the trading and settlement in securities of those companies which have failed to make the required demat arrangements by the above stipulated date, be shifted to Trade to Trade basis. Once any scrip is shifted to Trade to Trade basis, the transactions in the scrip are not netted and all purchase and sale transactions in the same scrip in single settlement are to be settled separately. For example, trading and settlement in securities of XYZ Ltd. have been shifted to Trade to Trade. An investor has bought 100 shares of the company in the morning on April 1, 2002 (Rolling Settlement No. 06/02-03) and he squares off purchase of these 100 shares by selling the same in the trading hours on the same day. In this case, his purchase and sale transactions would not be netted and the investor would be required to give delivery of 100 shares against his sale transaction and payment for the purchase transaction of 100 shares.

10.Q. Why BSE has included the scrips under Trade to Trade to "Z" group ?.

A. With a view to forewarn investors planning to make an investment in the securities of the companies, which have violated provisions of the Listing Agreement or have large investors complaints pending against them, the Exchange has shifted all such securities to a separate category called "Z" group. In "Z" group all the trades are settled on Trade to Trade basis. Moreover, an alert message "The scrip is in "Z" group where the trades would be settled on Trade to Trade basis. Do You Wish to Continue?" is flashed whenever a buy or sale order in a "Z" group scrip is placed

In order to give proper alert message on the BOLT system that trades in a particular scrip would be settled on Trade to Trade basis, the Exchange has included in "Z" group the securities of all

those companies which have failed to make demat arrangements with both depositories, latest by September 30, 2001.

The investors while trading in "Z" group scrips should, therefore, exercise caution while indicating "Yes" for the above message.

11.Q. What about scrips where trading and settlement takes place on Trade to Trade basis because of Surveillance reasons?

A. At times, the trading and settlement in scrips is placed by the Exchange on Trade to Trade basis because of Surveillance reasons. Such scrips are not included in "Z" group for settling transactions in these scrips on Trade- to- Trade basis and trading and settlement continues to be in their respective B1 or B2 groups. A $ sign is however, placed alongside the Scrip ID of the scrips in BOLT to indicate that trading and settlement in the scrip is on trade to trade basis. Further, the names of these companies are available in the News Category "Scrips under Trade-to-Trade- other than "Z" group" on the BOLT system. Investors should exercise due caution while placing orders in these scrips as netting of buy and sale position in the same scrip on the same day is not permitted.

12.Q. An investor holds shares of the company XYZ Ltd. The company has been included in "Z" group for not making demat arrangements. When the scrip of XYZ Ltd. would be shifted back from "Z" group?

A. The trading and settlement in the securities of those companies, which have failed to make demat arrangements by the stipulated time, have been shifted to "Z" group. Once these companies make demat arrangements with both the depositories, the trading and settlement in the same would be shifted back from the "Z" group to their original group after three months from the date of making the required demat arrangements by giving advance notice to the market.

13.Q. I am holding shares of XYZ Ltd., which has been included in "Z" group for not making demat arrangements. Whether, the company would be shifted out of "Z" group as soon as the company makes demat arrangements. Under what conditions the company would remain in "Z" group notwithstanding demat arrangements?.

A. The Exchange would normally shift out those companies, which have made demat arrangements, after three months from the date of doing so. However, if in the meanwhile, the company has been identified as "Z" Group Company on account of violation of provisions of the Listing Agreement or non-resolution of investor complaints, such companies would continue to be in "Z" group eventhough they might have made arrangement for demat.

14.Q. Can one deliver the shares in the physical form where only demat deliveries are permitted?

A. Yes! The investors can sell and deliver the scrips in the physical form where only demat deliveries are permitted. The Exchange settles such transactions under the Exit Route Scheme announced for scrips in compulsory demat delivery for all investors. The transactions of this type, which are executed in "C" group at the Exchange system, are settled on Trade-to-Trade basis, i.e., without netting of buy and sell position in the same scrip. The investors can sell only upto 500 shares in physical form at one time in one single order. The market deliveries are not permitted and the shares delivered have to be in the name of the investor.

15.Q. How to identify the scrips which are settled with compulsory demat delivery in the Rolling Settlements?

A. The trades in all "A", "B1" and "B2" group scrips can only be settled with demat delivery. However, the trades in B1 group securities of State Bank of Bikaner and Jaipur, State Bank of Travancor and State Bank of Mysore, although permitted in CRS on netting basis, are settled in physical form since these banks have obtained exemption from SEBI from dematerialization of their securities. Further, the trades in certain scrips which have

been mandated by SEBI for compulsory demat delivery for all investors but have been included in "Z" group by the Exchange are compulsorily required to be settled by demat delivery and the market lot of such scrips is 1 (one).

16.Q. What is the margining system in Rolling Settlements?

A. For the trades in CRS, Value at Risk (VaR) based margining approach has been adopted. In the VaR system of margining, historical volatility of scrips and overall market volatility represented by Sensex (at BSE) is considered to arrive at a VaR margin percentage for a scrip. As the scrips traded on the Exchange are divided into following two groups for calculation of VaR margins as per the SEBI directive, VaR margins are to be calculated depending on the group to which the scrip belongs.

Group I: 246 highly liquid scrips which had the facilities of BLESS, ALBM or MCFS or included in the BSE 200, mandated in Compulsory Rolling Settlements w.e.f. July 2, 2001 plus 15 scrips earlier placed in Compulsory Rolling Settlements having the facility of BLESS (Rolling)

Group II. remaining scrips.

VaR margin for Group I is calculated as the higher of Scrip VaR and Index VaR multiplier with a suitable multiplier and in Group II is calculated based on Daily Index VaR multiplied with a suitable multiplier.

These percentages calculated at the end of a day are applied on the next day's positions. The rates of margin are available for download by members. The same are also available on BSE website i.e., www.bseindia.com in Market Live- Market Summary Section on a daily basis. Further, the mark to market differences are collected on a daily basis and the member-brokers are required to maintain a capital level, as prescribed by the Exchange, adequate to support their exposure at all times.

17.Q. What is the circuit filters system applicable for scrips traded in Compulsory Rolling Settlements?

A. In case of 54 scrips, which are included in the SENSEX & S&P CNX Nifty or where derivative trading is permitted- daily 10% circuit filter is currently applicable. As such, the prices in these 54 scrips are allowed to move in a trading day on either side to the extent of 10% of their closing price on the previous trading day. For remaining scrips traded in CRS, a circuit filter of 20% is uniformly applied. However, the Exchanges have the power to reduce the circuit filter for surveillance reasons.

18.Q. An investor has sold shares in the CRS scrip for delivery, can he avoid paying VaR/Mark to Market losses?

A. Yes! the shares sold by an investor should be delivered to the Clearing House of the Exchange in demat form. From the day of delivery of such shares to the Clearing House, the gross exposure of the shares sold is excluded from the gross exposure of the member-broker and VaR margin and Mark to Market losses etc. on such quantity of shares sold is not computed.

19.Q. What happens if one fails to submit shares sold?

A. In case, one fails to deliver the shares sold in the Rolling Settlement, the Exchange conducts an Auction of the quantity short delivered/ not delivered on T+4, to meet the obligation of delivery of shares to the buyer. In this Auction session, offers are invited from fresh sellers for quantities short delivered. The highest offer price is allowed upto the close-out rate and the lowest offer price in auction can be 20% below the closing price on a day prior to the day of auction. The member through whom one has sold the shares is not allowed to offer shares in the scrip for which he has failed to make delivery.

In case no offers are received in auction for a particular scrip, the sale transaction is closed-out at a close-out price, determined by higher of the following:-

- Highest price recorded in the scrip from the settlement in which the transaction took place upto a day prior to the day of the auction.

OR

- 20% above the closing price on a day prior to the day of auction.

However, in case of the close- out of the shares under objections, shortages in the trades done in "C" group or "Z" group where the auction rate is not available, 10% above the closing price on a day prior to the day of auction is considered instead of 20% for calculation of the close- out price for scrips in other groups.

- In such case, if the auction price/close-out price is higher than the standard price of the settlement in which the transaction was done, the difference is recovered from the seller who has failed to deliver the scrips. However, in case, auction/ close-out price is lower than standard price, the difference is not given to the seller but is credited to the Investors Protection Fund.

20.Q. What happens if one buys shares on one day and sells the same on the following day and does not get delivery of shares purchased?

A. The pay-out of the shares purchased would take place on T+3 day. In case, an investor does not receive the shares purchased on account of non- delivery by the seller, he may receive the same in the auction pay-out on T+5 day. In case one has sold the shares on the next day, the pay-in of these shares would become due on T+4 day. This would lead to mismatch in delivery obligations for sale transactions, which became due on T+4 and receipt of the shares purchased via auction would happen on T+5 day. Hence, the sale transaction due on T+4 day would result into a failure and the shares not delivered would be auctioned or closed-out

However, the investors should note that the total shortages in the various scrips in the CRS are quite negligible, and the investors are most likely to get the shares purchased by them on the Pay-out day (T+3) itself. However, it is advisable to sell the shares purchased only after the same have been received by the concerned member-broker from the Exchange or have been credited to the demat account of the investor.

21.Q. How is the No-delivery fixed in Rolling Settlement?

A. The Stock Exchange announces a No-delivery period in scrips on the basis of intimation from the companies about Book Closure (BC)/Record Date (RD). During the period of No-delivery, the settlement of purchase/sale transactions is not effected. No-delivery period for various scrips is indicated in the settlement calendar of BSE (generally No-delivery period is for one week). The transactions in the scrips done at the Exchange during the No-delivery period are netted and settled in the settlement in which the scrips come out of No-delivery.

22.Q. What would happen in the scenario when the No- Delivery is abolished?

A. The No- Delivery system has till now been used to ensure that the trades takes place at the prices which are reflective of the corporate benefits attached to the securities traded. The Exchanges have decided to abolish No-Delivery for the scrips which are traded on compulsory demat form and Book Closure or Record dates have fixed by the companies for corporate benefits like bonus dividend and where no corporate benefits are attached. This would come into effect from May 1, 2002. In such cases the Exchange would announce an Ex-date and the investors should quote the prices for the concerned scrips assuming the corporate benefits are not attached from that date onwards. However, the No- Delivery would continue to be applicable for all scrips where physical shares can be delivered and/or where the corporate benefits are other than referred to above.

23.Q. Can one take advantage of price differential prevailing on two Exchanges in the Rolling Settlement?

A. It is likely that at certain point of time, there is a difference in the prevailing prices of a scrip on two Exchanges. However, in Rolling Settlements, the settlement of transactions on all Exchanges is done on T+3 and as such, the investors would be required to settle buy and sale transactions entered simultaneously on two Exchanges, on the same day and time. Therefore, the advantage of price difference can only be availed of, provided the investor holds securities sold on one Exchange and has funds to take delivery at the Exchange where securities have been purchased.

On Stock Markets

(Ever wondered how the budget affects the stock market?)

Article 1: Limit Order

(You think placing an order is easy? Dream on!)

Ever overheard a typical conversation between a broker and his client? Here is an excerpt of what it is usually like?

Client: What is the market rate of Infosys?
Broker: Quoting Rs7,500/505?
Client: OK, buy 100 shares of Infosys?

What will the broker do now? He will buy Infosys shares in the market at any (the best) available price till he has a 100 of them.

By buying shares for his client in this manner, the broker just executed a 'Market Order'.

What is a Market Order?

A 'Market Order' is an order to buy or sell a stock immediately at the best available price in the market. Sometimes it is referred to as an 'Unrestricted Order', since it comes with no conditions attached from the client.

Hence, it is the simplest order that can be placed in the market. The client just informs his broker to execute the trade and the broker executes the trade at the best price available in the market.

Interestingly, it is the only order that guarantees execution unless of course the 'circuit breakers' set by the exchanges come into play!

Hmm! Could anything go wrong here?
Imagine a situation where just as our client is placing his market order, a big fund places a 'market order' to buy 20,000 shares of Infosys!

The price is soaring through the skies and in the melee our client manages to buy his 100 shares of Infosys at Rs7,700! Our client is caught completely unawares.

Since the client thought that he was buying just 100 shares, he would have assumed that his trade would get executed very close to the market price of Rs7,550. In the end, he bought 100 shares a good Rs150 higher than expected. What if the client was playing it tight and cannot fork out the extra Rs15,000 that his 'market order' resulted in...?

Is there any way of avoiding these hazards while placing an order?

Hallelujah! Thank God for small mercies like the 'Limit Order'.

What is a Limit Order?
An order placed with a broker to buy or sell at a predetermined amount of shares at a specified price or better than the specified price.

So how would the conversation of our client with his broker have gone if our client knew about 'Limit Orders'?

Client: What is the market rate of Infosys?
Broker: Quoting Rs7,500/505?.
Client: OK, buy 100 shares of Infosys at Rs7,550.

What will the broker do this time around? He will buy 100 shares for our client at a price of Rs7,550.

In case a fund places a big 'market order' to buy 20,000 shares of Infosys on the same day and in the process takes the price to Rs7,700, our broker will wait for the price to come back to Rs7,550 before buying shares for our client.

Know the limits of a Limit Order
A good question may crop up at this stage: What if the price does not drop below Rs7,700 at all? Well, what can we say? Our client missed an opportunity to probably make a decent profit on Infosys? ! Too bad.

In other words, there is a flip side to using a 'Limit Order' vis-?is a 'Market Order'.

Which one, when? That depends on your timeframe
This depends on your time horizon. In case of our client, it depends on what he is buying the 100 shares of Infosys for. If he is buying these 100 shares with the intention of selling them within a month at Rs8,500, then it makes a lot of difference whether he buys it at Rs7,550 or Rs7,700.

On the other hand, if he is buying these 100 shares with the intention of holding it for the next five years during which time he hopes to sell it at Rs15,000, then the difference of Rs150 a share he sacrifices now pales in comparison to the profit of Rs7,450-7,300 per share he hopes to make over this long period.

In case the price never drops below Rs7,700, our client would have missed out on a Rs7,300 profit in 5 years because of insisting on saving Rs150! Reminds us of the proverb " Penny wise, pound foolish."

Of course, the knowledgeable amongst you would have figured out that 'Limit Orders' are more useful for the traders whereas the 'Market Orders' are more useful for the investors.

The tricky question is how do you set the limit for a 'limit order'?
The limit can be set based on your perception of what is the right value. After all, we have our own perception of value when we buy shirts or vegetables. This goes for stocks as well!

For traders, the limit price depends on the potential profits they see from that level, and their risk-reward playoff.

By the way, limit orders allow an investor to limit the length of time an order can be outstanding before cancelled. A quick look at the various limit orders that can be placed:

End of Day: Any order to buy or sell a stock that automatically expires if not executed on the day the order is placed.

Good till Date: Any order to buy or sell a stock that automatically expires if not executed on the date specified when the order is placed or the end of the particular settlement on the

exchange, whichever comes first.

End of Settlement or Good Till Cancelled: Any order to buy or sell a stock that automatically expires if not executed by the end of the settlement on the exchange unless the order is cancelled during that period.

Now that we have understood the basics of 'Limit Order', it is time to move on. Next, we will understand the 'Stop Loss' order better.

Article 2: Arbitrage between NSE & BSE

(A hard look at what this arbitrage business between NSE and BSE really means)

These set of transactions are probably the most badly understood transactions. The financial dailies have added to its popularity by just displaying closing price differences between the two exchanges to highlight profit making opportunities.

But they are misleading as very few shares actually change hands at that price. But to top it all these transactions are not 'arbitrage'!

The fact that you use the word 'arbitrage' must mean that the transaction is riskless and hence safe!

Are these transactions really riskless?

The arbitrage between NSE and BSE has two parts to it. In the first stage you sell on NSE and buy on BSE at the end of settlement (Tuesdays of every week) and then reverse the transaction on the very next trading day (buy on NSE and sell on BSE).

Why does arbitrage need to be executed in two phases?

The first part leaves an open position on two different exchanges with not only two different settlements but also two different settlement standards. Hence, you need to get your delivery from BSE and deliver at NSE. One goof up somewhere would mean 'auction' and 'penalty'. What was meant to be a 'free' lunch can end up being a very 'costly' luncheon. However, it's true that with dematerialisation the risks of delivery have been mitigated to a large extent

Once you have two parts to the transaction, you are still taking a risk- an overnite price risk. After all, prices can change sharply the following day on both the exchanges. You can say that you are betting on relative price differences between BSE/NSE and these could move in tandem after all. But what if the stock hits the lower circuit or the upper circuit? You can buy on one exchange but cannot sell on the other or vice versa. Gosh! You cannot complete your transaction and might get saddled with the position!

In short, this is not 'arbitrage' as it is not riskless. Unable to coin a better term people called it so. It is a misnomer.And it probably makes sense for a broker to indulge in such so called 'arbitrage' transactions.

For normal traders, it does not make sense paying brokerage four times and still carry out the transactions between the exchanges. A better option is to arbitrage between futures and the cash market or just take part in 'vyaj badla'.

Article 3: Fiscal policy and the markets

(There's no escaping fiscal deficit. Ever wondered how rising fiscal deficit affects the stock m...)

No escaping the fiscal deficit

There's no escaping the fiscal deficit. The thing has escaped from the pink papers, where it rightfully belongs, to the ordinary newspapers. The investor has enough on his mind tracking his portfolio, so why does he need to bother about the fiscal deficit?

Think of the government as the biggest player in the financial markets. That's the reason why we lesser mortals have to bother about it. It's a bit like the Unit Trust of India. When the UTI got into trouble last year, the markets took a tumble, and then waited with bated breath for UTI to get bailed out. And the government is many many times bigger than the UTI.

Sure, the government doesn't play the stockmarkets itself, except through its disinvestment programmes, but it controls the debt markets. The government's need for borrowing money to finance its expenses is nothing but another name for the fiscal deficit. No wonder it affects the entire economy.

Government borrowing affects the entire economy

How does it do that? Well, if government borrows too much, it "crowds out" the private sector. The stock of financial resources (money) being limited, excess government borrowing results in there being less left over for the private sector. Also, when government borrowings increase, the demand for credit increases relative to the supply for it. So the cost of credit increases. The cost of credit is nothing but the interest you pay. And when interest rates rise, that's obviously negative for companies, as higher interest costs eat into profits.

Borrowing from RBI-a surefire recipe for inflation

Sometimes, the government does not borrow directly from the market but instead borrows from the Reserve Bank. That's actually equivalent to printing money, and is called, in the jargon, monetising the deficit. When this happens, the amount of money supply increases and that makes price rise as well. Don't get it? Well if we all had a printing press at home in which we could print money then we could all become crorepatis. We could afford to pay any amount to buy anything we wanted to. Everything then becomes an auction and there is no limit on how high prices can go because there is no limit on how much you can afford to pay-after all, you have a printing press at home. But that is a surefire recipe for inflation.

When the government borrows from the RBI very much the same happens. Sure not all of us have a printing press. But this is one hell of a big printing press. So prices are bound to rise. And then the price that you pay for money (which is nothing but interest rates) begins to rise too up.

To keep deficit in check, government raises resources through higher taxes...

The moral of the story is that the government should cut its coat according to its cloth. How can the government do that? One easy way is to raise resources. The simplest way to do that, as we are painfully aware, is to increase taxes. Increased taxes takes away purchasing power from people, thereby reducing demand. It also dampens the incentive for people to work harder. During the bad old socialist days, marginal tax rates went up to over 90%, leading to a flourishing black economy. These days, thankfully, finance ministers realise that too much taxation is counter-productive. But the point is, whether the government chooses to tax more or not has implications for companies and therefore for the markets.

...and that impacts stocks

While corporate tax rates apply equally to all companies, changes in the rates of excise and customs duties affect different industries in different ways. That's why we have all those analyses

on budget day trying to gauge the impact of the budget proposals on industries and individual companies. Obviously stocks too are impacted.

Disinvestment-a resource-raising route which also affects market
The other way of raising resources is through disinvestment. Divesting the government stakes in good companies brings good quality investments into the stockmarket and helps investors.
Deficit can also be checked through expenditure cuts
But raising resources is not the only way to keep the deficit in check. The other way is to reduce government expenditure. Is that a good thing? It depends on the state of the economy. If there is a recession going on and there is substantial excess capacity, reducing the deficit would reduce purchasing power and hurt demand. The need here would be to increase government expenditure to kickstart the economy.

The quality of the deficit is of great import
At other times, however, reducing government expenditure would be a good thing. It depends, however, on what kind of expenditure you prune. If the government cuts down on capital expenditure, that is the expenditure required for building physical and social infrastructure, then economic growth is bound to suffer. Government investment in roads, telecom, ports, etc, has knock-on effects on the rest of the economy, improving productivity and raising investment demand. That translates into orders for capital goods companies. Growth obviously translates into growth for individual companies, raising their valuations. If, on the other hand, the government reduces subsidies, rationalises prices, and trims flab in an effort to become more productive, that is to be welcomed. In other words, it's not just the fiscal deficit that is important, but the quality of that deficit.

State of government finances should concern investors
The government, through its fiscal policy, has the power to control the economy, interest rates and with it, the direction of the markets. Investors have reason, therefore, to be concerned about the state of the government's finances.

Article 4: **Monetary policy and the stock market**

(The monetary policy has everything do to with inflation, interest rates and the stock market. W...)

Monetary policy affects all of us
You would have noticed the reams of newsprint churned out when the Reserve Bank of India announces its monetary policy every six months. Like a lot of people, you would have thought that

- it is merely another reason to fill the financial pages; or,
- more charitably, it may be important for banks but not for ordinary investors like you and me.

The fact is that RBI monetary policy has an effect on all investors. Let's take a look how.

A tool to control inflation, which directly affects interest rates
Monetary policy is aimed at controlling the level of inflation & interest rates in the economy. To do that, the Reserve Bank tries to lower the money supply when prices are rising. How does it do that? By lowering the amount of money available with banks. Raising reserve requirements, i. e., the amount of money which banks must keep impounded with the RBI, is one way.
Another method is to sell bonds to the banks. When banks buy bonds from the RBI, money flows out from banks to the RBI, lowering the amount of money available for lending. You'll

remember that just before the 1996 election finance minister Manmohan Singh tried his best to lower inflation, believing that a lower inflation rate would improve the chances of a Congress government. He got that wrong, but in the process RBI squeezed money supply.

What happened next is history. Because money was scarce, interest rates started moving up to astronomical levels. Companies found that they were starved of funds, or couldn't afford the high rates. The ultimate result was that the economy slid into a recession.

So by changing the money supply, the Reserve Bank can determine the level of interest rates. Higher levels of interest rates impact corporate bottomlines and discourage companies from investing. That slows down growth.

Does the process work the other way?

In other words, can the RBI spark an economic recovery by increasing money supply, with resultant lower interest rates? The evidence does not seem as strong. Lower interest rates can help in creating the right atmosphere for a recovery, but it is not enough to spark one by itself. Some kind of stimulus to demand must go hand in hand as well.

Impact on stockmarket

In the West, where both the bond as well as the equity markets are mature, an increase in interest rates leads to more money flowing into bonds. Other things remaining the same that means less money for the equity markets. You'll remember that late last year, when the Dow showed signs of weakness, Federal Reserve Chairman Alan Greenspan decided to lower the Federal funds rate and the discount rate. Lowering the rate at which banks could access Federal funds was a signal for interest rates to go down in the rest of the economy. Money flowed from the bond into the equity markets, the Dow crossed the magic 10,000 mark, and Greenspan single-handedly saved the world! In India, the bond markets are not very liquid, and only the banks are active in that market. Since banks do not invest in equities, except marginally, there is no flow of funds from the bond to the equity markets. So the impact of monetary policy on the equity markets here is indirect, rather than through the direct route.

There's yet another way in which higher interest rates affect the advanced economies. Because almost everyone in the US has borrowed up to his neck, interest rates are important for consumer spending. When interest rates rise, people spend less because they can't afford to borrow at the high rates. This lowers demand and slows the economy down.

However, the RBI does have a more direct way of influencing the stockmarket. That is by varying the percentage of funds which banks are allowed to invest in the stockmarket. At present, the limit is 5 per cent of the incremental deposits of banks. That means, if a bank gets Rs100 worth of new deposits, it can invest Rs5 in the stockmarket. Unfortunately, with banks not being very keen on investing in equity, their investments been far below the limit.

RBI can also influence exchange rates

The central bank also has the power to decide the level of the currency both by direct intervention and by targeting interest rates, which are a key factor in determining exchange rates. If it feels the rupee is too weak, it sells dollars in the market and buys rupees. If it feels the rupee should go down a bit, all it has to do is buy dollars. The rupee's exchange rate obviously has enormous implications for importers and exporters. What's more, even those companies which produce for the domestic market would be affected, because the price of imports would be changed. For instance, Reliance Industries would benefit if the rupee becomes stronger, as the price of competing imports would rise. Similarly, companies which export software would benefit when the rupee weakens.

Well so the next time the newspapers devote reams of newsprint to the monetary policy, scan it well-it has serious implications on the stock market.

Article 5: The MSCI Index

(Discover why the Indian stock market keenly watches the changes in the MSCI Index...)

Who is MSCI?

Morgan Stanley Capital International Inc. (MSCI) is a leading provider of global indices, benchmark related products and services to investors worldwide. MSCI indices are the most widely used benchmarks by global portfolio managers.

According to a recent survey by Merrill Lynch/Gallup, over 90% of the North American and Asian international equity assets are benchmarked to the MSCI Indices. In Europe too, over 50% of the continental fund managers peg their portfolios to the MSCI Indices.

Besides this, the MSCI has 1200 customers worldwide who use its indices as a benchmark. Hence any change in these indices has a significant impact on global capital markets.

What does it mean to be a benchmark?

How does the global fund manger decide where to invest his money and in what proportion (asset allocation as they call it)? He needs a benchmark that indicates the available investment opportunities around the globe.

The benchmark is typically an Index. The most popular global indices are the MSCI indices. The MSCI Indices (there are a basket of them) consist of various stocks from individual countries. The global fund managers can then benchmark their performance in two ways.

Either they can mimic the entire portfolio of stocks and hence peg the return to that of the index or they can choose some other stocks that can outperform the return of this index. Hence the portfolio manager's investment patterns are determined not just by how attractive the companies in your country are but also by the weight of your country in the MSCI index.

How is the index generated?

The MSCI equity indices are constructed in a consistent manner across all countries, encompassing a total of 23 developed markets and 28 emerging markets. This consistent approach to index construction ensures proper representation of the country's underlying industry distribution and market capitalization. It allows investors to accurately compare equity performance across markets, regions and sectors.

In this process, MSCI tracks developments in almost 3000 companies (both listed and unlisted) around the globe. These equities account for over 99% of the world's total market capitalization.

MSCI country equity indices are constructed using the following five steps:

- Define the listed securities within each country.
- Sort the securities into industry groups and select securities until 60% of each industry's market cap.
- Select the securities with good liquidity and free float.
- Avoid cross-ownership among stocks in the index.
- Apply the full market capitalization weight to each stock.

This method not only ensures the inclusion of every industry into the country's index, but also that they represent 60% of the market capitalization. In other words, one can determine

the performance of a particular country's market by calculating the returns of the country's MSCI index.

These 51 MSCI Country Indices are used to generate regional indices such as MSCI Europe Index, MSCI Emerging Market Index. Those global managers who want to expose their fund with a certain regional risk can use these regional indices.

The MSCI world index is constructed by combining the MSCI country indices under certain weightages. This world index is revised on a quarterly basis and therefore the country's weightage keeps shifting on the basis of expected performance of different MSCI Country Indices.

Powerful enough to affect country's capital market

It is very difficult for any global fund manager to track the whole world's equity market and optimize the profit of his portfolio. MSCI Indices cover almost 99% of the entire world's market capitalization; therefore almost 90% of the global managers from North America and Asia follow these indices for their investment decisions.

Here's the clincher. If MSCI revises weightage of any country in the MSCI world index then most of the global managers react to it and shift their investments correspondingly.

For example, if MSCI announces any dip in the India 's weightage in the world index and increases say Thailand 's weightage, then global managers will decrease their exposure to Indian stocks and the money will shift to Thai stocks.

Hence, these revisions of country's weight in the index can cause huge sums of capital to either flow in or out of a country changing the fortunes of its capital market.

MSCI's index changes may see India's weight dip -FE 16/5/2000

India's weight may be hit as MSCI overhauls systems - ET 16/5/2000

MSCI index to cut India weightage - BS 16/5/2000

Yesterday, all the financial newspapers highlighted a possible revision of MSCI's world index and a cut in India's weightage from the present 9% to 3%. But what is MSCI and why are people concerned over a possible revision of its indices?

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- Select the securities with good liquidity and free float.
- Avoid cross-ownership among stocks in the index.
- Apply the full market capitalization weight to each stock.

This method not only ensures the inclusion of every industry into the country's index, but also that they represent 60% of the market capitalization. In other words, one can determine the performance of a particular country's market by calculating the returns of the country's MSCI index.

These 51 MSCI Country Indices are used to generate regional indices such as MSCI Europe Index, MSCI Emerging Market Index. Those global managers who want to expose their fund with a certain regional risk can use these regional indices.

The MSCI world index is constructed by combining the MSCI country indices under certain weightages. This world index is revised on a quarterly basis and therefore the country's weightage keeps shifting on the basis of expected performance of different MSCI Country Indices.

Powerful enough to affect country's capital market

It is very difficult for any global fund manager to track the whole world's equity market and optimize the profit of his portfolio. MSCI Indices cover almost 99% of the entire world's market capitalization; therefore almost 90% of the global managers from North America and Asia follow these indices for their investment decisions.

Here's the clincher. If MSCI revises weightage of any country in the MSCI world index then most of the global managers react to it and shift their investments correspondingly.

For example, if MSCI announces any dip in the India's weightage in the world index and increases say Thailand's weightage, then global managers will decrease their exposure to Indian stocks and the money will shift to Thai stocks.

Hence, these revisions of country's weight in the index can cause huge sums of capital to either flow in or out of a country changing the fortunes of its capital market.

Article 6: Meet the Sensex

(We all know what the Sensex is. Or do we really?)

What is a stock index?
Probably, the first thing you ask your broker when you ring him during market trading hours is: where is the market? What does he mean when he says it is up 25 points (say)? He is referring to the Sensex being up by that much. Now one assumes you already knew that anyway. But do you know what the Sensex represents exactly?

The Sensex is a stock index that represents changes in values of share prices of a select group of companies over a base period.

The many uses of a stock index
The companies included in any stock index are generally leaders and representatives of their respective industries. Hence an index as a whole represents the wellbeing of the most important industries in an economy. And since industrial performance is a proxy for determining the state of an economy, we could say that the stock index itself also echoes the economic welfare of a country.

The index also acts as a barometer for market behaviour. So if the index value goes down, it means the market is bearish (selling, therefore not optimistic of an upward trend) and if it goes up then it is bullish (buying, in the expectation of a rise based on positive news/performance).

An index can be used to benchmark portfolio performances. In our write-up on MSCI indices, we saw that almost 70% of the global managers benchmark their portfolio returns against MSCI indices' returns.

Now in order to benchmark a portfolio or to evaluate the economy using the stock index, we need for it to have a value. We know that, for instance, both the Sensex and the Nifty possess values that change daily.

What a Sensex value represents
As per the definition of an index, a Sensex value of 4600 and Nifty value of 1400 (say) represent the change in the collective value of the share prices of select companies over a base period.

The BSE Sensex came into existence in the year 1979 with a start value of 100, whereas the NSE Nifty was born in year 1991 again with a start value of 100. That means the value of the companies in the Sensex has increased 42 times in 21 years, while the value of the companies in Nifty has jumped 14 times in 10 years.

Criteria for choosing Sensex companies
Moving to the next question that Sharekhan senses burning in your mind: On what basis is a company elected to be in a stock index? Why does the Sensex include an Infosys and not a Wipro? Here's what companies must have to play a part in any index:

Market capitalisation: The company's scrip should figure in the top 100 companies listed by market capitalisation. Also market capitalisation of the scrip should be more than 0.5% of the total market capitalisation of the index i.e. the minimum weightage in the index should be 0.5%.

Industry representation: Scrip selection would take into account a balanced representation of the listed companies. The index companies should be leaders in their industry group with sound management.

Scrip group: The stock should preferably be from the A trading group.

Trading frequency: The stock should have been traded on every trading day for the last one year.

Number of trades: The stock should be among the top 150 companies listed by average number of trades per day for the last one year.

Number of shares: The scrip should be among the top 150 companies listed by average number of shares traded per day for the last one year.

Trading activity: The average number of shares traded per day as a percentage of the total number of outstanding shares of the scrip should be greater than 0.05 % for the last one year.

Financial track record: The company should have either a consistent dividend paying record or a good profitability record.

Wipro does qualify on some criteria, such as the market capitalisation and being industry- representative, but on account of its low free float, it stays out of the Sensex. In contrast, Infosys qualifies on market capitalisation as well as liquidity and hence it forms a part of the Sensex.

Sensex companies are continuously monitored on the above characteristics and if in any year, a company does not satisfy all conditions, it is replaced by another company that does have all defined characteristics.

The magic of 100
In 1979, BSE decided to start Sensex (BSE-30). For this, it added the market capitalisation of all the selected thirty stocks at that time and divided the sum by a unique number to make the Sensex amount to a value of 100. This unique number is known as base of the Sensex.

This base is a very dynamic number and its value keeps changing with the changes in the composition of the Sensex or with the any change in the included companies' equity. Hence for all rights issue and any other change in the equity of the composite companies, the base of the index is adjusted so that the value of the index does not get destroyed.

Our Sensex is based on the market capitalisation of stocks that form part of the index. The greater the market capitalisation of a company, the higher its stock's influence on the Sensex movement. So, in the current scenario, an 8% increase in Infosys' share price affects the Sensex more than an 8% increase in Grasim's share price.

But market capitalisation is not the only possible influential factor. There are some more possible factors that can move the index, but before getting into that, we shall leave you to absorb the above. Happy musing!

Article 7: Stock Auctions

(Stock Auctions - the necessary evil that protects stock exchanges and investors)

Of auctions and their origin
The word auction, in simple terms, implies a public sale in which property or items of merchandise are sold to the highest bidder.

Did you know that auctions used to take place way back during the Homeric period in Greece? It was a means of transferring the ownership of slaves from one person to the other. This same underlying concept of auction has taken a more refined form in recent times - like the auction of commodities or the belongings of famous personalities. Have you ever been to an auction house like Christie's or Sotheby's, where works of art are sold to the highest bidder in auction?

Now, you are probably beginning to wonder what we are doing discussing auctions of slaves and commodities or art auction houses like Christie's and Sotheby's here, in the investment

jungle! Allow us to clarify that our intention is not to discuss art auctions per se, but auctions conducted on the bourses. Auctions are not conducted only to sell merchandise or works of art in big auction houses; they are also a common feature on stock exchanges.

Why conduct auctions in the stock market?
Auctions are conducted on the exchanges when, for some reason, shares (physical or demat) are not delivered to the exchange on time.

Exchanges conduct auctions to penalise the party for defaulting on delivering the shares on time, and thereby to protect the sanctity of settlements. It is a necessary evil - imagine the chaos if the defaulting party went scot-free and delivered shares at its own free will. This would trigger a chain reaction of defaults.

If the defaulting party fails to deliver the shares on time to the exchange, the exchange in turn is unable to deliver the shares to the party who purchased them. The purchasing party in turn might have already sold those shares before receiving them from the exchange and now it would be unable to deliver those shares on time. This vicious chain could go on and on.

Therefore, it becomes imperative that auctions are held so that pay-in and pay-out of shares take place on time, in accordance with the settlement cycle of the respective exchanges.

Reasons for shares to go on auction
Shares come under the hammer when they have been either delivered short or found to be objectionable by the exchange. Based on the reasons why shares qualify for auction, they have been categorised into two types:

1. Auction due to shortages
2. Auction due to objection

Auction due to shortages
As has been discussed above, an auction due to shortages takes place when the delivering party fails to deliver its share on time to the exchange, thereby triggering the vicious chain reaction of the exchange being unable to deliver the shares on time to the purchasing party and purchasing party in turn being unable to deliver shares on time if it has already sold it and so on... One of the common reasons why shares come under auction due to shortages is the confusion that arises about the delivery date of the shares, if they are going into the 'no delivery' period.

Auction due to objection
Physical shares go in for auctions not only if they are delivered short, but also if they are found to be objectionable and not rectified on time by the party concerned. There are many reasons why shares could come under objection. To list a few:

- Transfer deed attached to the share certificate is out of date
- Details like distinctive number, folio number, certificate number, transferor names etc are not filled or filled incorrectly on the transfer form attached with the share certificate
- Witness stamp or signature on transfer deed is missing

- Signature of the transferor is missing
- Delivering broker's stamp is missing on the reverse of the transfer deed
- Stamp of the registrar of the company is missing

When a share is returned to the broker by the exchange as objection, the broker is liable to inform the client and get the objection rectified. If the party fails to rectify the objection within a stipulated time period, then the shares go for auction. The defaulting party is then penalised by having to bear the auction price.

Does one always suffer a big loss in an auction?
The defaulting party does suffer a loss when their shares go in for auction. Imagine the rate at which the auction would take place if the market is rising and there is a great demand for the stock. The defaulting party would be required to pay for the difference between the higher auction price and the actual sale price of the stock.

Even in the case of a falling market when stocks are taking a beating, the defaulting party does not stand to gain the difference in the auction price and the actual sale price. The defaulting party instead has to forgo the entire sale proceeds it had earned.

Or even worse is the case when there are no participants in an auction. In such a case, the auction price is decided by the exchange. It varies with exchanges and is called the 'close-out' price.

How is the close-out price arrived at?
In three simple steps.

Step one: The exchange decides upon a 'fixed' price and adds 20% to it. Incidentally, the fixed price varies with exchanges.

For the Bombay Stock Exchange the fixed price is the 'standard rate/ hawala rate' decided by the exchange. This standard rate is calculated on the last day of the settlement. It is the simple average of all the trades executed on that particular day.

The National Stock Exchange, on the other hand, takes the closing price of the stock under auction as the fixed price. The closing price is arrived at by taking the weighted average of all the trades executed in the particular scrip in the last thirty minutes of the trading session.

Step two: The resulting price is then compared with the highest price for the stock in the settlement in which the defaulting party sold the scrip.

Step three: The higher of the two prices, ie the settlement price and the fixed price plus a 20% premium, is considered as the close-out price.

Which means if the fixed price decided by the exchange is higher than the settlement price, the settlement price is deemed as the close-out price. Alternatively, if the settlement price is higher than the fixed price, the stock is 'closed out' at the settlement price.

Understand things with Reliance
Let us understand this better with an example. Let us assume that a party has defaulted on shares of Reliance Industries (RIL). And his shares are up for auction on the BSE. The BSE 'fixes' the 'hawala' price for RIL at Rs320. And as per rule, it also adds 20% to the fixed price and arrives at the final price of Rs384.

Let us make another assumption at this stage. That the highest price in the settlement in which the defaulting party had sold the stock, was Rs400.

Now, obviously, the close-out will take place at the **settlement price of Rs400**, as it is higher than the **fixed price (Rs384)**.

Other side of the coin
What if the settlement had taken place at a price less than the fixed price of Rs384? What if it had taken place at, say, Rs305? Well, then the fixed price will be taken as the 'close-out' price as it is higher than the settlement price. And the stock will be auctioned at Rs384.

By now you must have got a fair idea about the kind of losses and inconveniences that one is forced to face if his shares go into auction. Which is why it becomes imperative that as responsible market players we maintain the sanctity of settlements by ensuring our shares get delivered on time.