



## FAQ-Secondary Market Department

### FAQs on Secondary Market

**Disclaimer:** These FAQs are not the interpretation of law but provide only a simplistic explanation of terms / concepts related to Secondary market. All information has been updated till February 28, 2009. For full particulars of laws governing the secondary market, please refer to the Acts/Regulations/Guidelines/Circulars appearing under the Legal Framework Section.

Some of the Questions for FAQs may be as follows:

1. Understanding “Financial Markets”
2. Understanding “Role of SEBI in the secondary market”
3. Who is a broker and sub-broker?
4. What is MAPIN?
5. What is margin trading facility?
6. What is securities lending and borrowing scheme?

### Understanding Financial Markets

#### 1. What are the various types of financial markets?

The financial markets can broadly be divided into money and capital market.

**Money Market:** Money market is a market for debt securities that pay off in the short term usually less than one year, for example the market for 90-days treasury bills. This market encompasses the trading and issuance of short term non equity debt instruments including treasury bills, commercial papers, bankers acceptance, certificates of deposits, etc.

**Capital Market:** Capital market is a market for long-term debt and equity shares. In this market, the capital funds comprising of both equity and debt are issued and traded. This also includes private placement sources of debt and equity as well as organized markets like stock exchanges. Capital market can be further divided into primary and secondary markets.

## 2. What is meant by Secondary Market?

Secondary Market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. Majority of the trading is done in the secondary market. Secondary market comprises of equity markets and the debt markets.

For the general investor, the secondary market provides an efficient platform for trading of his securities. For the management of the company, Secondary equity markets serve as a monitoring and control conduit—by facilitating value-enhancing control activities, enabling implementation of incentive-based management contracts, and aggregating information (via price discovery) that guides management decisions.

## 3. What is the difference between the primary market and the secondary market?

In the primary market, securities are offered to public for subscription for the purpose of raising capital or fund. Secondary market is an equity trading avenue in which already existing/pre- issued securities are traded amongst investors. Secondary market could be either auction or dealer market. While stock exchange is the part of an auction market, Over-the-Counter (OTC) is a part of the dealer market.

## SEBI and its Role in the Secondary Market

### 4. What is SEBI and what is its role?

The SEBI is the regulatory authority established under Section 3 of SEBI Act 1992 to protect the interests of the investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith and incidental thereto.

### 5. What are the various departments of SEBI regulating trading in the secondary market?

The following departments of SEBI take care of the activities in the secondary market.

Sr.No.	Name of the Department	Major Activities
1.	Market Intermediaries Registration and Supervision department (MIRSD)	Registration, supervision, compliance monitoring and inspections of all market intermediaries in respect of all segments of the markets viz. equity, equity derivatives, debt and debt related derivatives.
2.	Market Regulation Department (MRD)	Formulating new policies and supervising the functioning and operations (except relating to derivatives) of securities exchanges, their subsidiaries, and market institutions such as Clearing and settlement organizations and Depositories (Collectively referred to as 'Market SROs'.)
3.	Derivatives and New Products Departments (DNPD)	Supervising trading at derivatives segments of stock exchanges, introducing new products to be traded, and consequent policy changes

### Products available in the Secondary Market

#### 6. What are the products dealt in the secondary markets?

Following are the main financial products/instruments dealt in the secondary market:

**Equity:** The ownership interest in a company of holders of its common and preferred stock. The various kinds of equity shares are as follows:-

#### Equity Shares:

An equity share, commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holders of such shares are members of the company and have voting rights.

- **Rights Issue / Rights Shares:** The issue of new securities to existing shareholders at a ratio to those already held.

- **Bonus Shares:** Shares issued by the companies to their shareholders free of cost by capitalization of accumulated reserves from the profits earned in the earlier years.
- **Preferred Stock / Preference shares:** Owners of these kinds of shares are entitled to a fixed dividend or dividend calculated at a fixed rate to be paid regularly before dividend can be paid in respect of equity share. They also enjoy priority over the equity shareholders in payment of surplus. But in the event of liquidation, their claims rank below the claims of the company's creditors, bondholders / debenture holders.
- **Cumulative Preference Shares:** A type of preference shares on which dividend accumulates if remains unpaid. All arrears of preference dividend have to be paid out before paying dividend on equity shares.
- **Cumulative Convertible Preference Shares:** A type of preference shares where the dividend payable on the same accumulates, if not paid. After a specified date, these shares will be converted into equity capital of the company.
- **Participating Preference Share:** The right of certain preference shareholders to participate in profits after a specified fixed dividend contracted for is paid. Participation right is linked with the quantum of dividend paid on the equity shares over and above a particular specified level.
- **Security Receipts:** Security receipt means a receipt or other security, issued by a securitisation company or reconstruction company to any qualified institutional buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation.
- **Government securities (G-Secs):** These are sovereign (credit risk-free) coupon bearing instruments which are issued by the Reserve Bank of India on behalf of Government of India, in lieu of the Central Government's market borrowing programme. These securities have a fixed coupon that is paid on specific dates on half-yearly basis. These securities are available in wide range of maturity dates, from short dated (less than one year) to long dated (up to twenty years).
- **Debentures:** Bonds issued by a company bearing a fixed rate of interest usually payable half yearly on specific dates and principal amount repayable on particular date on redemption of the debentures. Debentures are normally secured / charged against the asset of the company in favour of debenture holder.
- **Bond:** A negotiable certificate evidencing indebtedness. It is normally unsecured. A debt security is generally issued by a company, municipality or government agency. A bond investor lends money to the issuer and in exchange, the issuer promises to repay the loan amount on a specified maturity date. The issuer usually pays the bond holder periodic interest payments over the life of the loan. The various types of Bonds are as follows-

Ø Zero Coupon Bond: Bond issued at a discount and repaid at a face value. No periodic interest is paid. The difference between the issue price and redemption price represents the return to the holder. The buyer of these bonds receives only one payment, at the maturity of the bond.

Ø Convertible Bond: A bond giving the investor the option to convert the bond into equity at a fixed conversion price.

- **Commercial Paper:** A short term promise to repay a fixed amount that is placed on the market either directly or through a specialized intermediary. It is usually issued by companies with a high credit standing in the form of a promissory note redeemable at par to the holder on maturity and therefore, doesn't require any guarantee. Commercial paper is a money market instrument issued normally for tenure of 90 days.
- **Treasury Bills:** Short-term (up to 91 days) bearer discount security issued by the Government as a means of financing its cash requirements.

## 7. What are the regulatory requirements specified by SEBI for corporate debt securities?

The term Corporate Bonds referred here includes all debt securities issued by institutions such as Banks, Public Sector Undertakings, Municipal Corporations, bodies corporate and companies having a tenure of more than 365 days. Such an issue of bonds, if offered to the public shall be required to comply with the SEBI (Disclosure and Investor Protection Guidelines), 2000. Also, a private placement of corporate bonds made by a listed company shall be required to comply with provisions contained in SEBI Circulars in this regard.

The SEBI Circulars dated September 30, 2003 and December 22, 2003 have laid out norms pertaining to the disclosure norms on issuance of such securities, which include compliance with Chapter VI of the SEBI (Disclosure and Investor Protection) Guidelines, 2000, Companies Act, 1956, listing agreement for debentures with the stock exchanges, rating to be obtained from a Credit Rating Agency registered with SEBI, requirement for appointing a debenture trustee registered with SEBI, mandatory trading in dematerialized form, etc.

In order to develop an exchange traded market for corporate bonds SEBI vide circulars dated December 12, 2006 and March 01, 2007 has authorized BSE and NSE to set up and maintain corporate bond reporting platforms to capture all information related to trading in corporate bonds as accurately and as close to execution as possible. Subsequently, FIMMDA has also been permitted to operate a reporting platform. As per the circulars, all issuers, intermediaries and contracting parties are granted access to the reporting platform for the purpose and transactions shall be reported within 30 minutes of closing the deal. The data reported on the platform is disseminated on websites of BSE, NSE and FIMMDA.

As a second phase of development, SEBI vide Circular dated April 13, 2007 has permitted BSE and NSE to have in place corporate bond trading platforms to enable efficient price discovery and reliable clearing and settlement in a gradual manner. To begin with, BSE and NSE have launched an order driven trade matching platform which retains essential features of OTC market where trades are executed through brokers. OTC trades however continue to be reported on the exchange reporting platforms. In order to encourage wider participation, the lot size for trading in bonds has been reduced to Rs.1lakh. Subsequently BSE and NSE may move towards anonymous order matching with clearing and settlement.

### **Role of Broker and Sub-broker in the Secondary Market**

#### **8. Whom should I contact for my Stock Market related transactions?**

You can contact a broker or a sub broker registered with SEBI for carrying out your transactions pertaining to the capital market.

#### **9. Who is a broker?**

A broker is a member of a recognized stock exchange, who is permitted to do trades on the screen-based trading system of different stock exchanges. He is enrolled as a member with the concerned exchange and is registered with SEBI.

#### **10. Who is a sub broker?**

A sub broker is a person who is registered with SEBI as such and is affiliated to a member of a recognized stock exchange.

#### **11. How do I know if the broker or sub broker is registered?**

You can confirm it by verifying the registration certificate issued by SEBI. A broker's registration number begins with the letters "INB" and that of a sub broker with the letters "INS". For the brokers of derivatives segment, the registration number begins with the letters "INF". There is no sub-broker in the derivatives segment.

#### **12. Am I required to sign any agreement with the broker or sub-broker?**

Yes. For the purpose of engaging a broker to execute trades on your behalf from time to time and furnish details relating to yourself for enabling the broker to maintain client registration form you have to sign the "Member - Client agreement" if you are dealing directly with a broker. In case you are dealing through a sub-broker then you have to sign a "Broker - Sub broker - Client Tripartite Agreement". Model Tripartite Agreement between Broker-Sub broker and Clients is applicable only for the cash segment. The Model Agreement has to be executed on the non-judicial stamp paper. The Agreement contains clauses defining the rights and responsibility of Client vis-à-vis broker/ sub broker. The documents prescribed are model formats. The stock exchanges/stock broker may incorporate any additional clauses in these documents provided these are not in conflict with any of the clauses in the model document, as also the Rules, Regulations, Articles, Byelaws, circulars, directives and guidelines.

### **13. What is Member –Client Agreement Form?**

This form is an agreement entered between client and broker in the presence of witness where the client agrees (is desirous) to trade/invest in the securities listed on the concerned Exchange through the broker after being satisfied of brokers capabilities to deal in securities. The member, on the other hand agrees to be satisfied by the genuineness and financial soundness of the client and making client aware of his (broker's) liability for the business to be conducted.

### **14. What kind of details do I have to provide in Client Registration form?**

The brokers have to maintain a database of their clients, for which you have to fill client registration form. In case of individual client registration, you have to broadly provide following information:

- Permanent Account Number (PAN), which has been made mandatory for all the investors participating in the securities market.
- Your name, date of birth, photograph, address, educational qualifications, occupation, residential status(Resident Indian/ NRI/others)
- Bank and depository account details
- If you are registered with any other broker, then the name of broker and concerned Stock exchange and Client Code Number.

For proof of address (any one of the following):

- Passport
- Voter ID

- Driving license
- Bank Passbook
- Rent Agreement
- Ration Card
- Flat Maintenance Bill
- Telephone Bill
- Electricity Bill
- Insurance Policy

Each client has to use one registration form. In case of joint names /family members, a separate form has to be submitted for each person.

In case of Corporate Client, following information has to be provided:

- Name, address of the Company/Firm
- Date of incorporation and date of commencement of business.
- Registration number(with ROC, SEBI or any government authority)
- Details of PAN
- Details of Promoters/Partners/Key managerial Personnel of the Company/Firm in specified format.
- Bank and Depository Account Details
- Copies of the balance sheet for the last 2 financial years (copies of annual balance sheet to be submitted every year)
- Copy of latest share holding pattern including list of all those holding more than 5% in the share capital of the company, duly certified by the Company Secretary / Whole time Director/MD. (copy of updated shareholding pattern to be submitted every year)
- Copies of the Memorandum and Articles of Association in case of a company / body corporate, partnership deed in case of a partnership firm
- Copy of the Resolution of board of directors' approving participation in equity / derivatives / debt trading and naming authorized persons for dealing in securities.
- Photographs of Partners/Whole time directors, individual promoters holding 5% or more, either directly or indirectly, in the shareholding of the company and of persons authorized to deal in securities.
- If registered with any other broker, then the name of broker and concerned Stock exchange and Client Code Number.

#### 15. What is meant by Unique Client Code?

In order to facilitate maintaining database of their clients and to strengthen the know your client (KYC) norms; all brokers have been mandated to use unique client code linked to the PAN details of the respective client which will act as an exclusive identification for the client.

#### 16. What is MAPIN?

MAPIN (Market Participant Identification Number) is the Market Participants and Investors Integrated Database.



The SEBI (Central Database of Market Participants) Regulations, 2003 were notified on November 20, 2003 under which, all the participants in the Indian Securities Market viz., SEBI registered intermediaries, listed companies and their associates and the investors were required to obtain a Unique Identification Number (UIN) in order to enable the regulator to establish the identity of person(s).

In the light of SEBI's order of making PAN the sole identification number for all participants transacting in the securities market, irrespective of the amount of transaction, it has been decided to discontinue with the requirement of Unique Identification Number (UIN) under the SEBI (Central Database of market Participants Regulations), 2005 (MAPIN regulations)/circulars. Accordingly, acceptance of MAPIN card as one of the documents for the purpose of Proof of Identity (POI) has been withdrawn.

#### **17. What is a risk disclosure document?**

In order to acquaint the investors in the markets of the various risks involved in trading in the stock market, the members of the exchange have been required to sign a risk disclosure document with their clients, informing them of the various risks like risk of volatility, risks of lower liquidity, risks of higher spreads, risks of new announcements, risks of rumours etc.

#### **18. How do I place my orders with the broker or sub broker?**

You can either go to the broker's / sub broker's office or place an order over the phone / internet or as defined in the Model Agreement given above.

#### **19. How do I know whether my order is placed?**

The Stock Exchanges assign a Unique Order Code Number to each transaction, which is intimated by broker to his client and once the order is executed, this order code number is printed on the contract note. The broker member has also to maintain the record of time when the client has placed order and reflect the same in the contract note along with the time of execution of the order.

#### **20. What documents should be obtained from broker on execution of trade?**

You have to ensure receipt of the following documents for any trade executed on the Exchange:

a. Contract note in Form A to be given within stipulated time.

b. In the case of electronic issuance of contract notes by the brokers, the clients shall ensure that the same

is digitally signed and in case of inability to view the same, shall communicate the same to the broker, upon which the broker shall ensure that the physical contract note reaches the client within the stipulated time.

It is the contract note that gives rise to contractual rights and obligations of parties of the trade. Hence, you should insist on contract note from stock broker.

## **21. What details are required to be mentioned on the Contract note issued by the Stock Broker?**

A broker has to issue a contract note to clients for all transactions in the form specified by the stock exchange. The contract note inter-alia should have following:

- Name, address and SEBI Registration number of the Member broker.
- Name of partner /proprietor /Authorised Signatory.
- Dealing Office Address/Tel No/Fax no, Code number of the member given by the Exchange.
- Unique Identification Number
- Contract number, date of issue of contract note, settlement number and time period for settlement.
- Constituent (Client) name/Code Number.
- Order number and order time corresponding to the trades.
- Trade number and Trade time.
- Quantity and Kind of Security brought/sold by the client.
- Brokerage and Purchase /Sale rate are given separately.
- Service tax rates and any other charges levied by the broker.
- Securities Transaction Tax (STT) as applicable.
- Appropriate stamps have to be affixed on the original contract note or it is mentioned that the consolidated stamp duty is paid.
- Signature of the Stock broker/Authorized Signatory.

Contract note provides for the recourse to the system of arbitrators for settlement of disputes arising out of transactions. Only the broker can issue contract notes.

## **22. What is the maximum brokerage that a broker can charge?**

The maximum brokerage that can be charged by a broker has been specified in the Stock Exchange Regulations and hence, it may differ from across various exchanges. As per the BSE & NSE Bye Laws, a broker cannot charge more than 2.5% brokerage from his clients.

## **23. What are the charges that can be levied on the investor by a stock broker?**

The trading member can charge:

1. Brokerage charged by member broker.
2. Penalties arising on specific default on behalf of client (investor)
3. Service tax as stipulated.
4. Securities Transaction Tax (STT) as applicable.

The brokerage, service tax and STT are indicated separately in the contract note.

#### **24. What is STT?**

Securities Transaction Tax (STT) is a tax being levied on all transactions done on the stock exchanges at rates prescribed by the Central Government from time to time. Pursuant to the enactment of the Finance (No.2) Act, 2004, the Government of India notified the Securities Transaction Tax Rules, 2004 and STT came into effect from October 1, 2004.

#### **25. What is an Account Period Settlement?**

An account period settlement is a settlement where the trades pertaining to a period stretching over more than one day are settled. For example, trades for the period Monday to Friday are settled together. The obligations for the account period are settled on a net basis. Account period settlement has been discontinued since January 1, 2002, pursuant to SEBI directives.

#### **26. What is a Rolling Settlement?**

In a Rolling Settlement, trades executed during the day are settled based on the net obligations for the day.

Presently the trades pertaining to the rolling settlement are settled on a T+2 day basis where T stands for the trade day. Hence, trades executed on a Monday are typically settled on the following Wednesday (considering 2 working days from the trade day).

The funds and securities pay-in and pay-out are carried out on T+2 day.

**27. What is the pay-in day and pay- out day?**

Pay in day is the day when the brokers shall make payment or delivery of securities to the exchange. Pay out day is the day when the exchange makes payment or delivery of securities to the broker. Settlement cycle is on T+2 rolling settlement basis w.e.f. April 01, 2003. The exchanges have to ensure that the pay out of funds and securities to the clients is done by the broker within 24 hours of the payout. The Exchanges will have to issue press release immediately after pay out.

**28. What are the prescribed pay-in and pay-out days for funds and securities for Normal Settlement?**

The pay-in and pay-out days for funds and securities are prescribed as per the Settlement Cycle. A typical Settlement Cycle of Normal Settlement is given below:

	Activity	Day
Trading	Rolling Settlement Trading	T
Clearing	Custodial Confirmation	T+1 working days
	Delivery Generation	T+1 working days
Settlement	Securities and Funds pay in	T+2 working days
	Securities and Funds pay out	T+2 working days
Post Settlement	Valuation Debit	T+2 working days
	Auction	T+3 working days
	Bad Delivery Reporting	T+4 working days
	Auction settlement	T+5 working days
	Close out	T+5 working days
	Rectified bad delivery pay-in and pay-out	T+6 working days
	Re-bad delivery reporting and pickup	T+8 working days
	Close out of re-bad delivery	T+9 working days

**Note:** The above is a typical settlement cycle for normal (regular) market segment. The days prescribed for the above activities may change in case of factors like holidays, bank closing etc. You may refer to scheduled dates of pay-in/pay-out notified by the Exchange for each settlement from time-to-time.

**29. In case of purchase of shares, when do I make payment to the broker?**

The payment for the shares purchased is required to be done prior to the pay in date for the relevant settlement or as otherwise provided in the Rules and Regulations of the Exchange.

**30. In case of sale of shares, when should the shares be given to the broker?**

The delivery of shares has to be done prior to the pay in date for the relevant settlement or as otherwise provided in the Rules and Regulations of the Exchange and agreed with the broker/sub broker in writing.

**31. How long it takes to receive my money for a sale transaction and my shares for a buy transaction?**

Brokers were required to make payment or give delivery within two working days of the pay - out day. However, as settlement cycle has been reduced from T+3 rolling settlement to T+2 w.e.f. April 01, 2003, the pay out of funds and securities to the clients by the broker will be within 24 hours of the payout.

**32. Is there any provision where I can get faster delivery of shares in my account?**

The investors/clients can get direct delivery of shares in their beneficial owner accounts. To avail this facility, you have to give details of your beneficial owner account and the DP-ID of your DP to your broker along with the Standing Instructions for 'Delivery-In' to your Depository Participant for accepting shares in your beneficial owner account. Given these details, the Clearing Corporation/Clearing House shall send pay out instructions to the depositories so that you receive pay out of securities directly into your beneficial owner account.

**33. What is an Auction?**

The Exchange purchases the requisite quantity in the Auction Market and gives them to the buying trading member. The shortages are met through auction process and the difference in price indicated in contract note and price received through auction is paid by member to the Exchange, which is then liable to be recovered from the client.

**34. What happens if the shares are not bought in the auction?**

If the shares could not be bought in the auction i.e. if shares are not offered for sale in the auction, the transactions are closed out as per SEBI guidelines.

The guidelines stipulate that "the close out Price will be the highest price recorded in that scrip on the exchange in the settlement in which the concerned contract was entered into and up to the date of auction/close out OR 20% above the official closing price on the exchange on the day on which auction offers are called for (and in the event of there being no such closing price on that day, then the official closing price on the immediately preceding trading day on which there was an official closing price), whichever is higher.

Since, in the rolling settlement the auction and the close out takes place during trading hours, the reference price in the rolling settlement for close out procedures would be taken as the previous day's closing price.

### **35. What is Margin Trading Facility?**

Margin Trading is trading with borrowed funds/securities. It is essentially a leveraging mechanism which enables investors to take exposure in the market over and above what is possible with their own resources. SEBI has been prescribing eligibility conditions and procedural details for allowing the Margin Trading Facility from time to time.

Corporate brokers with net worth of at least Rs.3 crore are eligible for providing Margin trading facility to their clients subject to their entering into an agreement to that effect. Before providing margin trading facility to a client, the member and the client have been mandated to sign an agreement for this purpose in the format specified by SEBI. It has also been specified that the client shall not avail the facility from more than one broker at any time.

The facility of margin trading is available for Group 1 securities and those securities which are offered in the initial public offers and meet the conditions for inclusion in the derivatives segment of the stock exchanges.

For providing the margin trading facility, a broker may use his own funds or borrow from scheduled commercial banks or NBFCs regulated by the RBI. A broker is not allowed to borrow funds from any other source.

The "total exposure" of the broker towards the margin trading facility should not exceed the borrowed funds and 50 per cent of his "net worth". While providing the margin trading facility, the broker has to ensure that the exposure to a single client does not exceed 10 per cent of the "total exposure" of the broker.

Initial margin has been prescribed as 50% and the maintenance margin has been prescribed as 40%.

In addition, a broker has to disclose to the stock exchange details on gross exposure including name of the client, unique identification number under the SEBI (Central Database of Market Participants) Regulations, 2003, and name of the scrip.

If the broker has borrowed funds for the purpose of providing margin trading facility, the name of the lender and amount borrowed should be disclosed latest by the next day.

The stock exchange, in turn, has to disclose the scrip-wise gross outstanding in margin accounts with all brokers to the market. Such disclosure regarding margin-trading done on any day shall be made available after the trading hours on the following day.

The arbitration mechanism of the exchange would not be available for settlement of disputes, if any, between the client and broker, arising out of the margin trading facility. However, all transactions done on the exchange, whether normal or through margin trading facility, shall be covered under the arbitration mechanism of the exchange.

### 36. What is SEBI Risk Management System?

The primary focus of risk management by SEBI has been to address the market risks, operational risks and systemic risks. To this effect, SEBI has been continuously reviewing its policies and drafting risk management policies to mitigate these risks, thereby enhancing the level of investor protection and catalyzing market development. The key risk management measures initiated by SEBI include:-

- Ø Categorization of securities into groups 1, 2 and 3 for imposition of margins based on their liquidity and volatility.
- Ø VaR based margining system.
- Ø Specification of mark to Market margins
- Ø Specification of Intra-day trading limits and Gross Exposure Limits
- Ø Real time monitoring of the Intra-day trading limits and Gross Exposure Limits by the Stock Exchanges
- Ø Specification of time limits of payment of margins
- Ø Collection of margins on upfront basis
- Ø Index based market wide circuit breakers
- Ø Automatic de-activation of trading terminals in case of breach of exposure limits
- Ø VaR based margining system has been put in place based on the categorization of stocks based on the liquidity of stocks depending on its impact cost and volatility. It addresses 99% of the risks in the market.
- Ø Additional margins have also been specified to address the balance 1% cases.
- Ø Collection of margins from institutional clients on T+1 basis

The liquid assets deposited by the broker with the exchange should be sufficient to cover upfront VaR margins, Extreme Loss Margin, MTM (Mark to Market Losses) and the prescribed BMC. The Mark to Market margin would be payable before the start of the next day's trading. The Margin would be calculated based on gross open position of the member. The gross open position for this purpose would mean the gross of all net positions

across all the clients of a member including his proprietary position. The exchanges would monitor the position of the brokers' online real time basis and there would be automatic deactivation of terminal on any shortfall of margin.

### **37. What is Short Selling and Securities Lending & Borrowing?**

Short Selling means selling of a stock that the seller does not own at the time of trade. Short selling can be done by borrowing the stock through Clearing Corporation/Clearing House of a stock exchange which is registered as Approved Intermediaries (AIs). Short selling can be done by retail as well as institutional investors. Naked short sale is not permitted in India, all short sales must result in delivery, and information on short sale has to be disclosed to the exchange by end of day by retail investors, and at the time of trade for institutional investors. The Securities Lending and Borrowing mechanism allows short sellers to borrow securities for making delivery. Securities in the F&O segment are eligible for short selling.

Securities Lending and Borrowing (SLB) is a scheme that has been launched to enable settlement of securities sold short. SLB enables lending of idle securities by the investors through the clearing corporation/clearing house of stock exchanges to earn a return through the same. For securities lending and borrowing system, clearing corporations/clearing house of the stock exchange would be the nodal agency and would be registered as the "Approved Intermediaries" (AIs) under the Securities Lending Scheme, 1997.

Under SLB, securities can be borrowed for a period of 7 days through a screen based order matching mechanism. Securities in the F&O segment are eligible for SLB.

### **38. What happens if I do not get my money or share on the due date?**

In case a broker fails to deliver the securities or make payment on time, or if you have complaint against conduct of the stock broker, you can file a complaint with the respective stock exchange. The exchange is required to resolve all the complaints. To resolve the dispute, the complainant can also resort to arbitration as provided on the reverse of contract note /purchase or sale note. However, if the complaint is not addressed by the Stock Exchanges or is unduly delayed, then the complaints along with supporting documents may be forwarded to SEBI. Your complaint would be followed up with the exchanges for expeditious redressal.

In case of complaint against a sub broker, the complaint may be forwarded to the concerned broker with whom the sub broker is affiliated for redressal.

### **39. What recourses are available to me for redressing my grievances?**



You have following recourses available:

- Office of Investor Assistance and Education (OIAE) : You can lodge a complaint with OIAE Department of SEBI against companies for delay, non-receipt of shares, refund orders, etc., and with Stock Exchanges against brokers on certain trade disputes or non receipt of payment/securities.
  
- Arbitration: If no amicable settlement could be reached, then you can make application for reference to Arbitration under the Bye Laws of concerned Stock Exchange.
  
- Court of Law

#### **40. What is Arbitration?**

Arbitration is an alternative dispute resolution mechanism provided by a stock exchange for resolving disputes between the trading members and their clients in respect of trades done on the exchange.

#### **41. What is the process for preferring arbitration?**

The byelaws of the exchange provide the procedure for Arbitration. You can procure a form for filing arbitration from the concerned stock exchange. The arbitral tribunal has to make the arbitral award within 3 months from the date of entering upon the reference. The time taken to make an award cannot be extended beyond a maximum period of 6 months from the date of entering upon the reference.

#### **42. Who appoints the arbitrators?**

Every exchange maintains a panel of arbitrators. Investors may choose the arbitrator of their choice from the panel. The broker also has an option to choose an arbitrator. The name(s) would be forwarded to the member for acceptance. In case of disagreement, the exchange shall decide upon the name of arbitrators.

#### **43. What happens if I am aggrieved by the award of the arbitrator?**

In case you are aggrieved by the arbitration award, you can take recourse to the appeal provisions as given in the bye-laws of the Exchange.

#### **44. What is Investor Protection Fund (IPF) / Customer Protection Fund (CPF) at Stock Exchanges?**

Investor Protection Fund is the fund set up by the Stock Exchanges to meet the legitimate investment claims of the clients of the defaulting members that are not of speculative nature. SEBI has prescribed guidelines for utilisation of IPF at the Stock Exchanges. The Stock Exchanges have been permitted to fix suitable compensation limits, in consultation with the IPF/CPF Trust. It has been provided that the amount of compensation available against a single claim of an investor arising out of default by a member broker of a Stock Exchange shall not be less than Rs. 1 lakh in case of major Stock Exchanges viz., BSE and NSE, and Rs. 50,000/- in case of other Stock Exchanges.

#### **45. What is BSE IndoNext?**

Regional stock exchanges (RSEs) have registered negligible business during the last few years and thus small and medium-sized companies (SMEs) listed there find it difficult to raise fresh resources in the absence of price discovery of their securities in the secondary market. As a result, investors also do not find exit opportunity in case of such companies.

BSE IndoNext has been formed to benefit such small and medium size companies (SMEs), the investors in these companies and capital markets at large. It has been set up as a separate trading platform under the present BSE Online Trading (BOLT) system of the BSE. It is a joint initiative of BSE and the Federation of Indian Stock Exchanges (FISE).

### **INTERNAL AUDIT OF STOCK BROKERS/ TRADING MEMBERS /CLEARING MEMBERS**

#### **46. Whether internal audit is applicable to all the brokers/trading members/clearing members including the inactive members?**

Internal audit is applicable to all the active brokers/trading members/clearing members. The in-active brokers/trading members/clearing members shall inform the respective stock exchange through a letter at the end of the respective inspection/audit period.

Definition of Active broker: A broker who had one or more trades during the inspection/audit period in the respective exchange is considered to be an active broker.

**47. What is the time-limit to submit the report? Where to submit the report?**

The internal auditor shall submit the report to the Proprietor / Partner / Board of the respective stockbroker/clearing member within 60 days from the end of the half year period.

The management of the respective stock broker/clearing member shall place the report before the board of directors / Proprietor / Partners who shall forward the same along with para-wise comments to the respective stock exchange within 3 months from the end of the half year period.

**48. Whether statutory auditor can do the internal audit of the same firm?**

Statutory auditor of the stock broker can not do the internal audit of the same stock broker/clearing member.

**49. Whether an auditor can do the internal audit of particular stock broker on continuous basis?**

Every 3 years the stock broker has to change the internal auditor. Further, where, in the opinion of the stock exchange, the quality of the report is not satisfactory or the audit has not been carried out as per the exchange guidelines, the stock exchange may advise the concerned member to change the auditor.

**50. Is there any assistance for data from Stock Exchanges/Depositories?**

Internal auditors are advised to collect all the required data from the respective stock broker/clearing members only.

**51. Does exchange/SEBI plans to have CA/CS/CMA empanelment?**

Currently, neither SEBI nor the exchanges have any plan to have CA/CS/CMA empanelment.

**52. What should be the format of the report?**

While no specific format is being prescribed, the internal auditor should cover all the areas mentioned in the scope/guidelines for the internal audit. Further the auditor should give a certificate of audit in the prescribed format.

### **Corporatisation and Demutualisation**

**53. What is the structure of the stock exchanges in India?**

There are 19 recognised stock exchanges in India. Mangalore Stock Exchange, Saurashtra Kutch Stock Exchange, Magadh Stock Exchange and Hyderabad Stock Exchange have been derecognised by SEBI.

In terms of legal structure, the stock exchanges in India could be segregated into two broad groups – 16 stock exchanges which were set up as companies, either limited by guarantees or by shares, and 3 stock exchanges which were set up as association of persons and later converted into companies, viz. BSE, ASE and Madhya Pradesh Stock Exchange. Apart from NSE, all stock exchanges whether established as corporate bodies or Association of Persons, were earlier non-profit making organizations. As per the demutualisation scheme mandated by SEBI, all stock exchanges other than Coimbatore stock exchange have completed their corporatisation and demutualisation process. Accordingly, out of 19 stock exchanges 18 are corporatised and demutualised and are functioning as for-profit companies, limited by shares.

**54. What is meant by corporatisation of stock exchanges?**

Corporatisation is the process of converting the organizational structure of the stock exchange from a non-corporate structure to a corporate structure.

Traditionally, some of the stock exchanges in India were established as “Association of persons”, e.g. the Stock Exchange, Mumbai (BSE), Ahmedabad Stock Exchange (ASE) and Madhya Pradesh Stock Exchange (MPSE). Corporatisation of such exchanges is the process of converting them into incorporated Companies.

#### **55. What is demutualisation of stock exchanges?**

Demutualisation refers to the transition process of an exchange from a “mutually-owned” association to a company “owned by shareholders”. In other words, transforming the legal structure of an exchange from a mutual form to a business corporation form is referred to as demutualisation. The above, in effect means that after demutualisation, the ownership, the management and the trading rights at the exchange are segregated from one another.

#### **56. How is a demutualised exchange different from a mutual exchange?**

In a mutual exchange, the three functions of ownership, management and trading are intervened into a single Group. Here, the broker members of the exchange are both the owners and the traders on the exchange and they further manage the exchange as well. A demutualised exchange, on the other hand, has all these three functions clearly segregated, i.e. the ownership, management and trading are in separate hands.

#### **57. Currently are there any demutualised stock exchanges in India?**

18 stock exchanges are demutualised in India, viz. BSE, NSE, Ahmedabad Stock Exchange, Madhya Pradesh Stock Exchange, Madras Stock Exchange, Cochin Stock Exchange, Bhubhaneshwar Stock Exchange, Bangalore Stock Exchange, OTCEI, Inter-connected Stock Exchange, Ludhiana Stock Exchange, Guwahati Stock Exchange, Vadodara Stock Exchange, Delhi Stock Exchange, Calcutta Stock Exchange, Pune Stock Exchange, Jaipur Stock Exchange and Uttarpradesh Stock Exchange.

### **General Questions**

#### **58. What are the relevant Rules and Regulations and where can I find them?**

You can browse through the “Legal Framework” section on the SEBI website <http://www.sebi.gov.in> for complete information relating to acts, rules, regulations, circulars, and guidelines relating to securities market.

#### **59. What is day trading?**

Day trading refers to buying and selling of securities within the same trading day such that all positions will be closed before the market close of the trading day. In the Indian securities market only retail investors are allowed to day trade.

#### 60. What are the main things an investor should be aware of while dealing with a broker/sub-broker?

Good understanding of investment opportunities alone may not help the investor in the securities market to trade. It is also important that the investor understands the process of investing, such as finding an appropriate broker, handling buying and selling of securities and maintaining records.

Before choosing a broker/sub-broker the investor should be aware of the following things:-

- Ø *From where the broker/sub-broker has learnt the business?*
- Ø *How long has he been serving the securities industry?*
- Ø *Whether he has eligible qualifications as a broker?*
- Ø *How many clients does he serve?*
- Ø *What fees and expenses does he charge?*

#### 61. What are the major obligations and responsibilities of a broker?

- a) Entering into an agreement with his client or with sub broker and client
- b) Maintenance of separate books of accounts and records for clients
- c) Maintenance of money of clients in a separate account and their own money in a separate account.
- d) Issue of daily statement of collateral utilization to clients
- e) Appointment of compliance officer
- f) Issue of contract note to his client within 24hrs of the execution of the contract.
- g) Delivery / Payment to be made to the client within 24 hrs of pay-out.
- h) Other duties as specified in the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992.

#### 62. What are the major rights and obligations of an investor?

- a) Before entering into a contract with the broker, ensure that he is registered with SEBI.
- b) Satisfy yourself about the credentials of the broker by asking for information/documents supporting his claims.
- c) Keep a documentary proof of having made deposit of money or securities with the broker.
- d) Before activating your trading account, obtain clear idea from your broker about all brokerage, commissions, fees and other charges which will be levied on your trades.
- e) Furnish details in full as are required by the broker as required in "know your client" (KYC) norms.
- f) Ensure that a contract note is issued by the broker which contains complete records of every transaction within 24hrs of the execution of the contract.
- g) In case pay-out of money and / or securities is not received on the next working day after date of pay-out, follow up with the concerned broker for its release. If it is not released within five working days, ensure to lodge a complaint immediately with the Investors' Grievance Cell of the exchange.
- h) Ensure to receive a complete 'Statement of Accounts' for both funds and securities settlement every quarter.

#### 63. What are the various accounts an investor should have for trading in securities market?

**Beneficial owner Account (B.O. account) / Demat Account:** It is an account opened with a depository participant in the name of client for the purpose of holding and transferring securities.

**Trading Account:** An account which is opened by the broker in the name of the respective investor for the maintenance of transactions executed while buying and selling of securities.

**Client Account / Bank Account:** A bank account which is in the name of the respective client and is used for debiting or crediting money for trading in the securities market.

**64. With whom should the investor file his complaint against an intermediary?**

In case an investor feels that his issue/problem/grievance is not being sorted out by concerned intermediary then he may take up the matter with the immediate/next higher level authority/SRO for the concerned intermediary. If the investor is not satisfied with the resolution of his complaint then he can escalate the matter to SEBI. Example: for complaint against sub-broker/broker you may approach stock exchange. For complaints against DPs, you may approach Depository.

In order to expedite the process of redressal of complaints and to make the process of lodging a complaint easier for the complainants, all SEBI registered intermediaries have been mandated to designate an e-mail ID of the grievance redressal division/compliance officer exclusively for the purpose of registering complaints. The intermediaries have also been advised to display the email ID and other relevant details prominently on their websites.

**65. Are all the investors mandated to comply with PAN requirement?**

Yes. With effect from July 02, 2007, PAN has been made mandatory for all the investors participating in the securities market. In order to strengthen the Know Your Client (KYC) norms and identify every participant in the securities market with their respective PAN to ensure sound audit trail of all the transactions, SEBI has mandated PAN as the sole identification number for all persons transacting in the securities market, irrespective of the amount of transaction.

**66. What is Trade for Trade Segment?**

In a Trade for Trade segment, settlement of trades is done on the basis of gross obligations for the day. No netting is allowed and every trade is being settled separately.

**67. How trading takes place and what is the process of trading?**

The normal course of online trading in the Indian market context is placed below:

**Step 1.** Investor / trader decides to trade

**Step 2.** Places order with a broker to buy / sell the required quantity of respective securities

**Step 3.** Best priced order matches based on price-time priority

**Step 4.** Order execution is electronically communicated to the broker's terminal

**Step 5.** Trade confirmation slip issued to the investor / trader by the broker

**Step 6.** Within 24 hours of trade execution, contract note is issued to the investor / trader by the broker

**Step 7** Pay-in of funds and securities before T+2 day

**Step 8.** Pay-out of funds and securities on T+2 day

In case of short or bad delivery of funds / securities, the exchange orders for an auction to settle the delivery. If the shares could not be bought in the auction, the transaction is closed out as per SEBI guidelines.

**68. What is Direct Market Access (DMA)?**

Direct Market Access (DMA) is a facility which allows brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker. Some of the advantages offered by DMA are direct control of clients over orders, faster execution of client orders, reduced risk of errors associated with manual order entry, greater transparency, increased liquidity, lower impact costs for large orders, better audit trails and better use of hedging and arbitrage opportunities through the use of decision support tools / algorithms for trading. Presently, DMA facility is available for institutional investors.

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