BEGINNER'S BRIEF

INSIDE THE STOCK EXCHANGE

BY

V.D. SONDE
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The historical background
V. D. Sonde

In this advertising age when the “selling” of a product has become the most important step in its journey to the ultimate consumer, it is strange that the Stock Exchange gets free publicity and has come to be the most widespread institution. Its importance in the normal life of mankind is evidenced by the prominence given to its activities in the daily press. Weekly and monthly editions solely devoted to its activities make regular appearances. No other business buys such publicity which, it may be pointed out, is beyond the purchasing power of any other business, industry or profession. While the cognoscenti are fully conscious of its importance, majority of the country, the uninstructed asks, “What is a Stock Exchange, what does it stand for, and what is the reason for its existence?” He is also puzzled by the name “Stock Exchange.”

Before proceeding further, an interesting question, “What are stocks and what are shares?”, required to be answered. In reality, there is a basic difference between a stock and a share as between a tube and a pipe. In simple terms, the two words mean a “division of, or fraction in, a larger undertaking launched for an object, or to bring in a profit”. Mr. F.E. Armstrong, in his definitive work on the London Stock Exchange, “The Back of the Stock Exchange” says, “There is little difference between shares and stocks. Both signify a division of the company’s capital. It was the practice of railway companies for instance, when they were formed, to issue stocks in which form the public were able to acquire an interest. People living when the railway system was born eagerly cooperated with the geniuses whose brains evolved the steam engine. They tendered their cash and watched the tracks lead their way across the land. The participation they took was in the form of stock, divisions of £ 100 in the company’s future. There was no reason why the capital should not have been in share units of £ 1 each.”

Raison d’être

It is now necessary to apply oneself to seek an answer to the question, “What is the reason for the Stock Exchange’s existence?” One may well question the necessity of answering this question, considering that day in day out a lot of writings are churned out by statisticians, economists, and others of the ilk, all drawing attention in the direction of this fascinating business of the Stock Exchange. Shrouded by this verbiage, however, is the cardinal principle that the Stock Exchange fulfills a felt need of the economic system that we follow and therefore serves the society and is not, as is mistakenly supposed by the people at large, a view which surprisingly finds support from the public financial institutions which ought to know better, a preserve of brokers.

As Mr. Armstrong has very lucidly pointed out, few people would subscribe their hard-earned capital to an enterprise where no facility exists for repayment if required. In support, he quotes the following lines of Mr. Colin Brooks in his “Profits from Short-term Investments”:

“Whoever has tired of holding his shares and sells them to Smith the company is unaffected. Similarly when Tomkins, having lent his money to the State, wishes to release it and sells his war loan to Jones, the State is no affected. The increase of the State has had the original money... and will some day perhaps repay the money borrowed to an equivalent holder. In the meantime it will pay dividend or interest to any one who has the title to the payment... The point is that few people are ready to tie up their surplus wealth indefinitely. James may be willing to subscribe a hundred pounds of capital in 1596... but in 1937 or 1947 he is not necessarily willing to use the returns of that money. No company could flourish which guaranteed to pay off its capital subscriber's money on demand... when therefore an invitation is made to the public to subscribe money the position arises that the acceptors of that invitation must be assured that they can recover their money when they need it, but the borrower cannot guarantee any such immediate recovery. The Stock Exchange supplies the need. It says in effect, “If you have £ 100... lend it to me for 10%, and I will pay you 10% on it. I will pay you £ 10 in addition to your original share in the loan.”

The Stock Exchange is therefore an institution which exists for the purpose of providing a market for stocks and shares. It has been evolved by time and perfected by experience. It offers for listed securities an open auction market where buyers and sellers from all over the country meet on terms of perfect equality and evolve a competitive market price. The dealings take place subject to a well-defined code of bye-laws and regulations, and full and prompt publicity is given to every transaction. This promotes the flow of saving into investment in the listed securities and facilitates their immediate conversion into cash at quoted prices. However, the Stock Exchange does not vouch for the listed securities. Price determination and value judgments involve constant scrutiny and assessment of each company from the business, financial accounting, and legal points of view; formulating such judgments based on constant scrutiny and assessment is primarily the function of the buyers and sellers in the market. All that the Exchange ensures is continuing surveillance and assistance in the establishment and development of sound and progressively higher standards of current practice and procedure.

Not for brokers alone

If, therefore, the Stock Exchange exists for sufficient economic reason and is thus a vital segment of the nation’s life, why then the feeling that the Exchange belongs to the brokers and it exists to subordinate needs to the detriment of the people at large? Why do the brokers feel that it is their private preserve and intrusion from outside quarters must be resisted at all costs? Why are the Exchange’s bye-laws and regulations primarily intended to safeguard the interests of the members only? Why should there be bye-laws prohibiting members from advertising when in every other business or industry this is freely permitted? Why do members of the Stock Exchange avert that they are carrying on a profession and at the same time the Rules make a provision for suspension by inheritance? Above all, why is there an equally reciprocated feeling amongst the outsiders that the Exchange belongs to its members and its regulation is primarily their concern? Though recently there has been a change in this perception, it has not gone far enough. Nevertheless, answers to all the above questions are available if we delve into the past, into the origins or the roots of this institution.

Century old roots

The Bombay Stock Exchange was formally established on December 3,
From the close of the eighteenth century till the Indenture was executed on December 5, 1857, the brokers or traders in stocks and shares had a checkered career in the country but mainly at two centres viz. Bombay and Calcutta. By the 1830s, there was a perceptible increase in the volume of business, not only in loans but also in corporate stocks and shares. While in Bombay business was reported in the stores of firms like the Commercial Bank, the Chartered Mercantile Bank, the Chartered Bank, the Oriental Bank, the old Bank of Bombay and some cotton presses, Calcutta newspapers quoted quotations of the loans of East India Company as well as the shares of Bank of Bengal. Business was also being transacted in the shores of Union Bank, Asia Bank and business ventures like Bengal Bombey Warehouse, the Banking Company and the Steam Tug Company. But the number of brokers was limited. In Bombay, barely a dozen brokers were recognized by the bank.

**Companies Act, 1856**

The enactment in 1856 of the Companies Act introduced the concept of limited liability and acted as a catalyst in ushering in the era of modern joint stock enterprise in India. There was rapid development of commercial enterprise. The gradual improvement in the efficiency of communications, brought about by the extension of railways and introduction of telegraphs, promoted internal trade and commerce. As there was no question of managing the foreign exchange as we understand to-day, foreign trade prospered with increasing demand for European manufactures accompanied by a corresponding demand in Europe for our exports. Sharebrokers were not far behind in availing of this prosperity. By 1860 their number swelled to 50 under the leadership of the legendary Premchand Roychand who was perhaps the first broker who could speak and write English and who has left behind the still-standing piece of architecture - Rajraaj Tower - in the gardens of the Bombay University.

The real step to the commercial activity was provided by the American Civil War which broke out in 1861. The complete stoppage of the supply of cotton from the United States to Europe provided the Bombay Presidency which was the principal cotton growing centre in India an opportunity to double its exports from 5,660,000 bales to 11,188,000 bales. As the exports were being paid for in bullion, between 1861 and 1865, the price of silver and gold worth Rs.52 crores flowed into the city of Bombay and this served as fresh capital for a number of new ventures. Between 1858 and 1864 there were at least 83 companies with the paid-up capital of nearly Rs.20 crores and market capitalisation of Rs.36 crores.

The speculation boom

The history of what followed makes interesting reading. In the words of the Bank of Bombay, it appeared "from this period every one in Bombay appears to have become wild with the spirit of speculation. Companies were started for every imaginable purpose - banks and financial associations, railways, coal mines, reclamation, trading, cotton cleaning, pressing, and spinning, hotel companies, shipping and steamer companies and companies for making bricks and tiles." Speculative activity, generated by the madness evidenced by the premia commanded by some of the newly floated companies which is detailed below:

<table>
<thead>
<tr>
<th>Name of the Co.</th>
<th>Paid-up Market Value (Rs.)</th>
</tr>
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<tbody>
<tr>
<td>Asiatic Bank</td>
<td>200</td>
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<tr>
<td>Bank of Bombay</td>
<td>500</td>
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<tr>
<td>Back Bay Declamation</td>
<td>5,000</td>
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<tr>
<td>Port Canning</td>
<td>1,000</td>
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<tr>
<td>Morgan Ltd.</td>
<td>1,000</td>
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The giddy spirit behind this hectic activity was Premchand Roychand who was described as the 'shadow of the prophet's guard'. The catching description of this frenetic activity is best provoked by the following passage:

"Man and woman, master and servant, employer and employee, banker and merchant, trader and artisan, rich and poor, of all races and creeds, officials in high positions included, were deeply busy from day to day in the art of printing pieces of paper variously called 'bollotments', 'scrip', and 'shares' into gold and silver."

**The crash of 1865**

The proverb says that all good things in life must come to an end. History who has the bad habit of repeating itself, like the South Sea Bubble and the Tulip Mania of the 18th century in Europe, the share mania of 1861-65 came to an end on July 1, 1865 when hundreds of tickets bargained with no one to fulfil them. In the disastrous slump that followed, Bank of Bombay's share fell to Rs.8 against the peak of Rs.2,550 and the Back Bay Reclamation share fetched not more than Rs.1,750, against the peak of Rs.50,000. Investors found that the entire wealth received during the Civil War was represented by a huge mass of unsaleable paper. The Stock Exchange Bombay, Premchand Roychand and his broker friends were "unanthemised" against the background of large-scale company failures. The government of the day had to step in with a special
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Stock brokers who had come together for a specific purpose of trading in stocks and shares. No wonder, then, that the bye-laws and regulations which they gave to themselves were essentially confined to protect their own rights and privileges and internally ban advertisement by individual firms so as to avoid unfair competition between members. All this was the provision that in the case of a deceased member the rules confirm the right of nomination to the wife and sons of the deceased. It is this provision which throws up the real issue against the claim that stock broking is a profession and not a business. Professional connections exist to the extent that individual skill and talents are acquired and not inherited. Such of the stock brokers who have acquired expertise in investment counseling have done so, not because it is required of them as membership qualification, but because it enables them to participate in the growth and prosperity of the stock exchange. The stock exchange is a place of business, however, and not by devolution from father to son. The quality and membership has radically changed in recent years. The only place is that of a broker or underwriter to intervene and there is a stream of fresh air blowing in. This creates well for the future.

Not so independent

The Bombay Stock Exchange took London as its model. But English institutions, the rules and regulations, have been adapted to the needs of the country. The Bombay Stock Exchange has voluntarily changed its Bye-laws and regulations and many of the perceptions of stockbrokers have been radically changed. Such a change has been possible because the English are flexible and can adapt themselves to new situations. The Bombay Stock Exchange, however, is still a product of the past and it is trying to keep pace with changes in society. It is the Bombay Stock Exchange that has been able to evolve new rules and regulations and many of the perceptions of stockbrokers have been radically changed. Such a change has been possible because the English are flexible and can adapt themselves to new situations. The Bombay Stock Exchange, however, is still a product of the past and it is trying to keep pace with changes in society.

India is a controlled economy. There is no segment of the economy which remains unaffected by some form of governmental action. The Bombay Stock Exchange has always claimed that they act as barometers of the state of the economy. While this is possibly true in the case of a free and unfettered economy, Indian Stock Exchanges cannot lay such claims. How else does one explain the phenomena in the stock markets last year? When every possible economic indicator showed only a marginal improvement in the state of the economy occasioned by the liberal policies of the new government, the equity index showed itself over the years. The Bombay Stock Exchange, it seems, can still be argued that the Stock Exchange performance was justified.

It therefore becomes incumbent on regulatory bodies to ensure that the Bombay Stock Exchange is no longer a close preserve of its members. It serves an economic necessity in the life of the Indian citizen. A situation where the activities of a few members who affect the vital interests of millions of citizens is unacceptable. The Bombay Stock Exchange is as much a public utility as, for example, the fire service. It must function with due regard to the interests of the large body of investors. Whatever may be its origin, its justification for continued existence lies in its ability to provide a forum for finance, to lay the foundations for fresh capital, to ensure that money, which has been earned, is not wasted. The Bombay Stock Exchange is necessary in the public interest.

In future articles, I shall discuss various topics relating to the Stock Exchange such as (a) membership, (b) listing requirements, (c) type of securities traded, (d) nature of trading, (e) purchase and sale of securities from the investor's point of view. The Bombay Stock Exchange needs a system of self-regulation to the exclusion of outside interference. We in India on the other hand have been historically looking up to the government to initiate the changing process. It is for this reason that when the year 1923 was reached, the bye-laws and regulations of the Bombay Stock Exchange were more restrictive than those in other stock exchanges in India.

Note: In preparing this article I have drawn freely from Mr. F. E. Symons book, "The Growth of the Stock Exchange", and the pamphlets published by the Stock Exchange Foundation, Bombay.

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Eligibility criteria for membership

Membership of a recognised stock exchange in India is a privilege, for members are permitted under the Act to trade or act as brokers for the purchase and sale of securities. There are present 13 stock exchanges which have been recognised under the Securities Contracts (Regulation) Act, 1956 but they differ in their organisational pattern. Excluding Bombay, Madras and Calcutta where there are voluntary non-profit-making associations, the rest of the exchanges are run either by companies limited by shares or by guarantee. Thus, the total membership is roughly in the neighbourhood of 2,500. These differences apart, the regulations governing the admission of members are uniform. Rule 8 of the Securities Contracts (Regulation) Rules, 1957 lays down the eligibility requirements for election to membership. Special provisions whenever necessary are made having regard to the nature of the organisational control of the Exchange but basically the requirements of Rule 8 must be complied with before a candidate is admitted as a member.

What follows in this article is based on the procedure followed in Bombay which, as stated above, is a voluntary non-profit making association. Under the Rules, Bye-laws and Regulations of the Exchange, the exchange was mainly established to "support and protect in the public interest the character and status of brokers and dealers and to further the interests of both of brokers and dealers and of the public interested in securities, to assist, regulate and control in the public interest dealings in securities, to promote fair dealing and to maintain high standards of commercial honour and integrity, to promote and inculcate honourable practices and just and equitable principles of trade and business, to discourage and to suppress malpractices, to settle disputes and to decide all questions of usage, custom or courtesy in the conduct of trade and business."

The High Powered Committee appointed by the government to make recommendations for the reorganisation of the stock exchanges is reported to have made some recommendations relating to the admission of members. These recommendations are still under consideration of the government and therefore this article deals with the provisions as they are presently in vogue.

Eligibility don'ts

Rule 8 of the Securities Contracts (Regulation) Rules provides that no person shall be eligible to be elected as a member if he is less than twenty-one years of age; or is not a citizen of India; or has been adjudged bankrupt or proved to be insolvent even though he has obtained his final discharge; or he has committed fraud or other dishonest act; or he has committed fraud or other dishonest act while he was employed in his creditor's business. If he has been convicted of an offence involving fraud or dishonesty; or he is engaged as principal or employee in any business other than that of a securities business; or a broker or agent not involving any personal financial liability unless he undertakes on admission to sever his connections with such business; or he is associated with or is a member of or subscriber to or shareholder or debentureholder in or connected through a partner or employee with any other organisation, institution, association, company or corporation in India where dealings in securities are carried on; or he is a director, partner, or employee of a company whose principal business is that of dealing in securities; or if he has been at any time expelled or declared defaulter by any other stock exchange.

In the case of a person who is not a citizen of India, admission is possible if in suitable cases, the governing body relieves the condition with the prior approval of the Central government. The governing body can also suspend the privilege of the candidate in business involving personal liability, with prior approval of the Central government for a specified period provided such business is not connected with an institution where forward business is carried on whether in securities or commodities.

It would appear that these provisions that a non-resident Indian citizen can become a member of a recognised stock exchange. He may be a member of an institution abroad where forward business is carried on in commodities or where business in securities is carried. But no person can become a member in more than one stock exchange where a person has been refused admission to membership, he cannot be considered again unless one year has elapsed after the date of such rejection.

Rule 8(4) specifically excludes from membership companies as defined in the Companies Act, 1956 but under Rule 8(5) partnerships are accepted, provided the partners satisfy the eligibility conditions laid down as indicated above.

Negative norms

The eligibility qualifications for membership are thus indicated in a negative manner. The Rules do not anywhere state what qualifications the applicant seeking membership of a Stock Exchange should have. They mention the circumstances in which a candidate may not be accepted as a member. This is required to be contrasted with the provisions regarding admission of members in the London or New York Exchanges. In both the places, the Rules indicate specifically the conditions which an applicant must satisfy. This difference in approach is perhaps due to the fact that in India stock broking has been taken as a business and not a profession. This approach also accounts for the fact that there is no requirement of minimum academic qualification. One needs no academic qualification to carry on business whereas it is a must in a profession. A doctor's son does not become automatically a doctor nor a lawyer's son a lawyer. But in India it is possible under the existing rules for a stockbroker's son to step into the shoes of his father.
However, a change is in the offing. All Exchanges except Bombay have a rule that the applicant must have passed the higher secondary or equivalent examination. The High Powered Committee has also made the same recommendation. Hence, the Bombay Stock Exchange now requires an outside candidate to be a graduate and a candidate, who inherits his father's card or is born of parents working for a long time in the Exchange, must be a matriculate. In London, the requirement is that the candidate must have passed the 'subject' "Stock Exchange Practice" of the Stock Exchange examination or been exempted therefrom.

**Corporate membership in UK**

It was mentioned earlier that under the SC(10) Rules, companies are specifically forbidden to become members. Press reports indicate that the High Powered Committee has recommended it for admission of limited companies as members. The exact nature of the recommendation is not known. It will therefore be of interest to explain the London provisions in this regard. London recognises two types of corporate membership: (1) Unlimited Corporate Members; and (2) Limited Corporate Members. An "Unlimited Corporate Member" has been defined to mean a company registered under the Companies Act not having any limit on the liability of its members and having as its sole main object the carrying on of the business of a Broking Firm or Jobbing Firm (but not both) in accordance with the Rules and Regulations. In contrast, a "Limited Corporate Member" is a company registered under the Companies Act not having any limit on the liability of its members and having as its sole main object the carrying on of the business of a Broking Firm or Jobbing Firm (but not both). In such cases, the business of the company should be the business of a broking firm. However, they differ in the liability provisions. In the case of an Unlimited Corporate Member, the shareholders have unlimited liability for the debts and obligations of the company; whereas in the case of a Limited Corporate Member, the liability of the directors alone is absolute.

Under the bye-laws of the Bombay Stock Exchange, membership constitutes a personal permission from the Exchange to exercise the rights and privileges attached to the right of membership. A member is permitted to assign, mortgage, pledge, hypothecate or charge his right of membership. Any attempt to do so will be void against the Exchange which has a right to expel any member who violates this Rule. A member is permitted to have the right of nomination which ceases on his death or default and the same varies in the Exchange. It is in interpretation of this provision that the Bombay High Court has held that the right of nomination does not pass to the legal heirs on the death of a member. But if the stock and the shares therein (whether or not in the name of any other person) remain with the sanction of the Governing Board or the nominee appointed under the Bye-Laws, and the nominee, it may be held that the nominated person may not be the only nominee.

**Nomination required**

Presently, therefore, a person desiring to become a member of the Bombay Stock Exchange must obtain a nomination in the prescribed form from an existing member of not less than seven years standing. The form is issued on receipt of a written application signed by the proponent and containing the full name of the proponent. It is obvious that such a candidate applies for a membership standing in the Exchange.

There is a prescribed form for the application for membership. The candidate must be recommended by two members of whom at least one is a member of the Governing Board. The application must be accompanied by a statement signed by the candidate that the applicant is not on the payroll of any company that has a representative on the Governing Board. If the application is found to be in order, the Governing Board examines the application and considers it for acceptance. If the application is approved, the candidate is admitted as a member of the Exchange.

**Election by ballot**

The election of new members is by ballot. A candidate is selected by a committee of three members, who is elected by the Board to answer any questions put to them.

**By-laws**

The by-laws of the Bombay Stock Exchange provide that a member who acts as a representative of the authorising member and enters into a contract with the Exchange not in its own name or in the name of such member, he is forbidden to enter into a contract with another member in the name of any other person. He is also forbidden to employ any authorised clerks. It is apparent that the authorising member is responsible for all the bargains made

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the market by his representative member and he shall fulfill the bargains in the same manner as if such bargains were made by him. In the absence of any agreement in writing to the contrary, it is deemed that the representative member has agreed to fully and completely indemnify the authorizing member for any loss sustained by him in his dealings. The Rules also provide that the representative member may be permitted to issue to his duly contract notes in his own name on depositing with the Exchange security in the required amount.

Security deposit

On his admission, a member has to provide security of such sum as the Exchange requires from time to time before he is permitted to carry on the business. Presently the security is Rs. 60,000 and it may be furnished by a member either by a deposit of cash or in the form of a deposit receipt of an approved bank or in securities approved by the Governing Board. As the cash deposit does not carry any interest, members prefer to deposit securities. The securities so deposited are transferred to the name of the Bank of India (which runs the Clearing House of the Exchange).

However, the High Powered Committee has since recommended that in Bombay, the amount of deposit should be raised to Rs.1 lakhs and it must be deposited in cash, except in circumstances where the Board deems fit, 25% of the same may be accepted in securities. Where a member also deals in specified shares, there is an increase of 100% i.e. the security will be of Rs.2 lakhs. As most of the members do business in both the categories of shares, effectively the security will generally be of Rs.2 lakhs, in every case.

When a member is declared a defaulter, he at once, ceases to be a member of the Exchange and ceases to enjoy all the rights and privileges of membership without any impairment to the rights of the creditor members against him. His right of membership vests in the Exchange. But he can be readmitted as a member under the following conditions:

(i) He should have made out of his own resources and independently of his security and margin deposits a bona-fide money payment of not less than 30% of the amount of loss he has incurred whether on his own account or his principal. Where the default is due to insolvency, the payment to the creditor members will have to be made to the Exchange or not, should be 100%.

(ii) His default should not have been contributed by reckless dealings on his own account or if his conduct has been marked by indiscipline and by the absence of reasonable caution.

It was mentioned earlier that a firm can be a member of the Exchange. If the Exchange does not recognise a partnership except—(a) between two or more members; or (b) between a member and his son or sons or his brother’s sons; or (c) between two or more members and their relatives as mentioned in (b) above.

It is also provided that the relatives mentioned above cannot be admitted as partners unless they are eligible in all respects for membership of the Exchange.

Other provisions

There is an apparent conflict in the Rules of the Bombay Exchange about the security payable by the non-member relatives. But from a harmonious reading of the proviso to Rules 36 and 183(a) of the Exchange, it would appear that the non-member relatives are not to furnish any security by themselves but that the member who admits them as partners should provide security to the extent of 50% of the normal security payable.

The other relevant provisions in regard to partnership are:

(i) A person can be a partner in one firm only;
(ii) Partnership with non-members is forbidden and so also with suspended members without the permission of the Governing Board;
(iii) Partnership interest cannot be assigned or encumbered;
(iv) Prior approval of the Board is necessary to form a partnership;
(v) Changes in partnership should be communicated to the Board;
(vi) No member can conduct business under a firm name unless he has at least one partner;
(vii) Misleading names are not permitted;
(viii) All partners are jointly and severally liable in respect of all dealings of the firm. All members are equally liable and guilty of any act or omission;
(ix) Partners with individual members of a partnership are not permitted and the firm shall not be liable for any business transacted in this manner.

The member of the Board of continuing partner of a partnership firm is permitted, with the permission of the Governing Board, to continue the business in the name of the firm of which he was a partner.

It is not necessary that a member must carry on the business personally. He can give a Power of Attorney to a non-member to carry on or supervise his Stock Exchange business. But such a non-member must in all respects be eligible for membership and prior approval of the Board is to be obtained. However, he should be personally responsible for all acts of his attorney.

Appointing clerks

A member is also permitted to appoint authorised clerks in his own exclusive employment for entering into bargains in the market on his behalf. Presently having regard to the volume of business, the Board of the Bombay Exchange has permitted every member to engage seven authorised clerks. However this facility is not available to a representative member. Prior permission of the Board is necessary for the appointment of authorised clerks as they are granted privilege of entering the floor and making bargains.

The authorising member is liable for all bargains made in the market by the clerks employed by him, but he is not liable for money borrowed by them unless he has given special authority for that purpose.

It will be noticed that under the Rules, the authorised clerk has to be in the employ of the authorising member and is expected to make bargains on his behalf only. However, by a long tradition, a class of persons has developed in the Indian stock market, as perhaps elsewhere, who are known by the generic name as 'bargain holders' or 'jobbers' or 'Taravelawallahs'. These persons get an authorisation or a licence to a member and trade i.e. purchase and sell either (i) on their own account or (ii) on the account of their authorising members; or (iii) on the account of such other members with whom they do business. They have no master and servant relationship with the authorising members. The profit or loss in individual transactions is shared as per arrangements mutually arrived at usually on a fifty-fifty basis. These jobbers generally keep their daily business squared up at the end of the day. They quote two-way prices and afford liquidity to the market by quoting two-way prices, it is argued that they prevent uneven fluctuations. Their unity in times of emergency is sometimes disputed as they instead of reversing the trend, are prone to accelerate the same. Nevertheless, over a period of time, they have become an integral part of the Indian stock market.

The High Powered Committee has made certain suggestions regarding the registration of the authorised clerks, jobbers and sub-brokers. Provision is also being made for keeping security deposits with the Exchange. Government has intimated acceptance of these suggestions and has desired their speedy implementation. Stock Exchanges have expressed their reservations in this regard and it is understood that representations are being made.

In the next article, the types of securities traded on the floor of the Exchange and the regulations which the companies have to comply with for getting their securities listed on the Exchange will be discussed.

V.D. Sonde

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Listing: significance/requirements

This is the third installment of "Inside the Stock Exchange" by Mr. V.D. Sonde. This serial is intended to give the reader an insight into the working of Stock Exchanges.

The Securities Contracts (Regulation) (SCRR) Act, 1956 defines "securities" to include -
(a) Shares or stocks, debentures, bond, preference shares, and other marketable securities of a listed company, or any incorporated company or body corporate.
(b) Government securities, and
(c) Rights or interests in securities.

The Act also defines a "Stock Exchange" to mean a body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling, or dealing in securities.

Under the Companies Act, a company limited by shares can issue two kinds of shares namely - (a) Equity shares, and (b) Preference shares.

Types of shares

While equity shares are of one type only, preference shares are of different types. Equity shareholders are the company owner and share equally in proportion to their holdings, the residue of the company's profits and assets, after all prior claims are met. Preference shares, on the other hand, are a fixed income-bearing security and have a preferential right to a fixed amount, as regards dividend, and (ii) as regards capital, in the event of winding up or other arrangement to repayment of capital, there is a preferential right to be repaid and the amount of capital paid-up on each share. These shares can be of four distinct categories (a) redeemable or non-redeemable, (b) cumulative or non-cumulative, (c) participating or non-participating, and (d) convertible or non-convertible.

Debentures play a significant role in the Stock Exchange, though investor demand for preference shares is rather weak.

Debentures

The other security of a company that is actively traded is the debenture. Debentures are usually considered to be a debt of a company being in the nature of a loan incurred on its assets. Debenture holders do not share in the company's prosperity although, through them, prosperity is possible. They have no voting rights as their holdings are not a part of the company's share capital. However, they have a prior claim on the assets of a company and can take control of the assets and compel winding up of its activities in case of a default in payment of interest.

Debentures are of six types - (a) registered debentures, (b) unregistered debentures, (c) redeemable debentures, (d) un-redeemable debentures, (e) convertible debentures, and (f) non-convertible debentures. In registered debentures the names of owners are recorded in the company books, payment of interest and principal is made to these registered holders. Ownership is transferred by a transfer deed. Unregistered debentures are bearer debentures and the names are not registered in the company books. They are freely negotiable and interest and capital on maturity is paid to the bearer. However, the currency of such debentures is limited.

Debentures which are redeemable on a specified future date or on demand or on notice are called redeemable debentures. Those for which there is no fixed date for redemption are called irredeemable; these are not popular with investors.

Finally, there is the category which at present commands great acceptance at the hands of the investors viz. convertible or non-convertible debentures. Though this group also falls in the category of redeemable debentures, the redemption in the case of convertible debentures is not by way of cash payment but conversion into the shares of the company as per the terms specified at the time of issue. The conversion in the case of convertible debentures is left to the option of the debenture holders and not at specified dates.

Provisional documents

According to the bye-laws of the Stock Exchange, dealings are not permitted in the provisional documents issued by a listed company. The term "provisional documents" is defined to include coupons, fractional certificates, letters of assignment, transferable letters of allotment, acceptance or application or options or other rights or interests or securities or other similar documents in respect of a company.

Normally, in any recognized Stock Exchange, members deal in the securities listed on their Exchange but under the bye-laws of the Governing Board may at its discretion and subject to such conditions as it may deem proper permit dealings in securities listed on any other Stock Exchange in India. Even in the case of unlisted securities, specific bargains are possible with prior permission of the Governing Board or the member. However, the stock-exchange specifically bars dealings subject to admission or in prospectus dividends. This means that transactions in securities issued by a company before listing are illegal.

But what is listing? In brief, "listing" means the admission of company securities to trading privileges on a Stock Exchange. The principal objectives of listing are:

(a) To provide ready marketability and impart liquid and free negotiability to securities;
(b) To ensure proper supervision and control of dealings;
(c) To protect interests of shareholders and the investing public.

It is important to note however, that the Stock Exchange does not vouch for the listing securities. It may not stand sponsor for them or guarantee their investment values. It only ensures continuing sponsorship and assistance in the establishment and development of sound prospectus and procedure. Price determination and value judgements involve constant scrutiny and assessment of each company from the business, financial, accounting, legal and technical points of view. Therefore, they are primarily the functions of the buyers and sellers in the market and not the Exchange.

Significance of listing

Why then do the companies get their securities listed? Listing is a purely voluntary action. There is no statutory
BEGINNER’S BRIEF

According to government guidelines, the face value of new equity shares should be Rs. 10 each and that of new preference shares and non-convertible debentures bonds should be Rs. 100 each. For convertible debentures bonds having a single point of conversion, the non-convertible portion should have a face value of Rs. 100. If there are two points of conversion, the portion after the first conversion itself should have the face value of Rs. 100.

Minimum public offer and minimum number of shareholders: It is mandatory under Rule 9(2) (b) of the SCR Act that a company comprises of at least 10% of the class of securities for subscription through advertisements in newspapers for a period of not less than three days and ensure that the applications so received are allotted fairly and unconditionally. However, this requirement is relaxed by a Stock Exchange with the previous approval of the Central government.

Guidelines in public interest

Industry in India has been the benefit of the government. The grant of licences, the release of scarce foreign exchange, the protection of market from foreign competition, localisation measures like tax holidays and developmental incentives, establishment of specialised financial institutions for providing capital through guarantees, loan arrangements and deferred credits—these open up opportunities for productive employment which cannot be a monopoly of private interest and must be for the benefit of the general investing public. Thus, the guidelines issued by the government from time to time stipulate that the list will not be open for more than ten days when it is advertised by financial institutions and for a period of not more than 21 days when the issue is not advertised.

Prospectus and Application Forms: The requirements in this regard are:
(i) The prospectus or an announcement thereof should be advertised in newspapers at least ten days before the opening of subscription.
(ii) The shares must be listed on the regional Stock Exchange. Where the market capital is Rs. 1 crore or more, there should be listing in one more Stock Exchange.
(iii) The prospectus must state that the subscription list will be kept open for at least three working days. It must provide that the list will not be open for more than ten days when it is advertised by financial institutions and for a period of not more than 21 days when the issue is not advertised.
(iv) There should be no restrictions on application from non-resident Indians and persons of Indian origin resident abroad.
(v) Where the issue is of more than Rs. 1 crore, application should be received in some designated centres.
(vi) The application forms must be in the prescribed forms.
(vii) Companies are required to invite applications in denominations of the market units of trading and permitted to invite application money at up to 100% of the issue price at their discretion.
(viii) The prospectus must also caution against the submission of multiple applications.

To be Continued

V.D. Sonde
Publicity guidelines

In addition to the above, the government has issued guidelines relating to the supply of copies of prospectus and application forms; scales of payment of underwriting commission and brokerage; remuneration to the issue managers; restriction of underwriting only to public financial institutions, banks, approved investment companies or trusts of appropriate standing and experience and members of recognized stock exchanges. The guidelines also relate to new issue publicity. In short, government has stipulated that, between the date of the announcement and the closing of the subscription list, no material relating to the new issue should be published by the companies directly or through their associates and should not to release at press conferences any information not contained in the prospectus. Similarly, no advertisements of over-subscription should be given till the subscription list is closed. Unfortunately, these publicity guidelines are not always honoured.

Allotment against the subscriptions received by the public: This topic divides itself into two parts. The first relates to the requirements before the company’s proposal for the allotment of shares is approved by the stock exchange. The second is concerned with what the company must do after the approval is given.

It will be noticed that all application forms bear serial numbers in seven digits. The first step is to segregate the applications into different categories such as 100 shares, 200 shares, 500 shares, etc. Then all multiple applications in the same name or with joint shares are weeded out. Unfortunately, in recent years a pernicious system of multiple applications with different names with the same postal address has arisen. Weeding out such applications by computer is not possible. But if it can be done manually, the company should delete these applications if they are beyond a reasonable figure. It is then to then reverse the digits and rearrange the applications with the new numbers in an ascending order. The allotment of shares is then proposed in each category having regard to the number of applications received. Preference is to be given to applications in the smaller categories and the others are accommodated in a descending order. However, the maximum allotment must not exceed the share capital and the number of shareholders should not be beyond 10 per Rs. 1 lakh. If full allotment is not possible, as in cases of over-subscription, with draft proposals on the basis of government guidelines, the company seeks the approval of stock exchanges. After modifying the proposals, if necessary, lots are drawn by the executive director of the stock exchange in the presence of the representatives of the company and managers to the issue.

The after-allotment requirements may also be noted. The company has to issue allotment letters as well as regret letters together with the refund orders within two months of the date of the closure of the subscription list or such extended period as allowed by the stock exchange concerned. It is essential that the time schedule (Sec. 73) be adhered to. If there is a delay beyond this period, companies will be required to pay the applicants interest at the rate of 12% p.a. in respect of the excess application money for the delayed period beyond 10 weeks from the date of the closure of the subscription list. The guidelines also give details regarding the mode of payment in cases where the allotment is made in full. (ii) where partial allotment is made and (iii) where no allotment is made at all. It is usual practice to send the postal orders to the head office of the尪 company, and these postal orders are collected by the postal authorities. A limited number of registered letters are also sent to the applicants.

Accepting the recommendations of the High Powered Committee, the government has since fixed an overall ceiling of the cost of public issue as under:

(a) Convertible debentures
(1) Upto Rs. 5 crores Mandatory cost +5%
(2) In excess of Rs. 5 crores Mandatory cost +2%
(b) Non-convertible debentures
(1) Upto Rs. 5 crores Mandatory cost +4%
(2) In excess of Rs. 5 crores Mandatory cost +1%

The listing agreement. The company is also required to file a formal listing application to the stock exchange comprising of the following: (1) letter of application (2) form of application, (3) supporting documents (4) distribution schedule, and (5) listing agreement.

The letter of application is a request by the company for the securities to be listed on the stock exchange. The application form calls for detailed information under numerous heads such as the organisational pattern of the company and its history. Supporting documents include memorandum and articles of association, debentures, prospectus, underwriting agreements, service and selling agreements, specimen of shares certificates, etc.

The distribution schedule is the most important document and has to
be filed for each class of security issued by the company. It shows the distribution of the securities according to the number of shares held by various categories of shareholders. For example, it shows how many own shares (or debentures) of the nominal value of Rs. 5,000 from Rs. 5,000 and up to Rs. 10,000, etc. The shares are spaced out at Rs. 10,000 up to Rs. 50,000. Thereafter there are two categories of Rs. 50,001 and up to Rs. 1,00,000, Rs. 1,00,001 and above.

The names and holdings of foreigners including non-resident Indians, government and government-sponsored financial institutions, corporate bodies, other top fifty shareholders, directors, their relatives, friends and associates, and office bearers of the company are also required to be disclosed.

Before listing, the company has to enter into a listing agreement with the Exchange. This is a very important document as it embodies covenants of performance by the company applying for listing its shares and provides for continuing relations between the company and the Stock Exchange. The listing agreement has to be executed under the seal of the company. The present listing agreement contains 40 clauses and its general purpose is to provide for the requirements to facilitate smooth and orderly trading in the market. For the sake of convenience the clauses are grouped into three parts: (i) clauses relating to the protection of the shareholders' interests; (ii) clauses facilitating smooth working of the market; and (iii) clauses relating to disclosure of information about the company's working.

Protection of shareholders' interests

These clauses are primarily meant for the shareholders or the investors who own the shares of a listed company to have a smooth relationship with it in matters relating to letters of allotment, lodgment of shares for transfer, consolidation or splitting of the shares, etc. The points to be emphasized in this regard are that the company undertakes (i) to issue certificates within one month of the date of lodgment for transfer, sub-division, consolidation, renewal or exchange; (ii) to consolidate or split certificates into market lots free of charge and in other cases after charging such fees as are agreed to between it and the Exchange; and (iii) if, in view of the volume of business in listed securities of the company, the exchange so desires, to maintain a transfer register in Bombay on which the securities are to be transferred. In addition, the company undertakes to give preferential benefit to existing shareholders in respect of any issue of fresh capital. Unless the shareholders in the general meeting decide otherwise.

Clauses facilitating smooth functioning of the market

These relate essentially to the closure of the Transfer Books (i.e., the Register of Members) and the meetings of the directors for the purpose of declaration of dividends, or a right or bonus issue or in part of convertible debentures. The transfer books have to be closed with the approval of the Exchange from a date suitable to its settlement programme and the company is required to give notice of 31 days. The stipulation in regard to the meeting of the Board of Directors is that the intimation must be given without any delay and the recommendation regarding dividends and/or cash bonuses should be notified at least five days before the commencement of the closure of transfer books or the record date for the purpose. Two points are worth mentioning in this regard. The first is that though no definite period is given regarding the notice of the directors' meeting, it is advisable that the company ensures that the date of intimation and the date of the meeting there is at least one day when the market is open for trading. Secondly, it is not advisable to intimate one purpose for召集ing the meeting and for directors to consider an additional item. It is not ethical to convene a meeting, for example, for considering the declaration of dividends and then to also consider the grant of bonus.

Clauses relating to disclosure of information

This information is necessary to enable shareholders or prospective investors to appraise the company's position. Therefore the company, after the meeting of the Board of Directors is held for the purpose, is required to inform the Exchange as follows:

(a) All dividends and/or cash bonuses recommended or declared or the decision to pass any dividend or interest payment;
(b) The total turnover, gross profit/loss, various provisions for tax and other liabilities, net profit and the amounts appropriated for the various reserves etc.
(c) Short particulars of increase in capital either by way of bonus shares or issue of right shares;
(d) Short particulars of any other alterations in capital.

The other information which the company must disclose to the Exchange relates to:

(a) Periodical working results in a form prescribed for the purpose;
(b) Any proposed change in the general character of its business;
(c) Any change in its Board of Directors.

(d) Any events such as strikes, lock-outs, closure on account of power cuts etc. to enable the shareholders and the public to keep informed. The purpose here is to enable the shareholders to hold the management responsible if anything goes wrong and to avoid the establishment of a false market.

The agreement also contains a clause under which the company is required to fix and notify the Exchange at least twenty-one days in advance of the date on and from which the dividend will be payable and to issue simultaneously the dividend warrants which shall be encashable at par at all the branches of its bankers and at such centres as are agreed to with the Exchange so as to reach the shareholders on or before the date fixed for payment of dividend.

Safeguards against takeovers

Finally, the listing agreement was amended a couple of years back to regulate takeover bids. A takeover bid has been defined to mean an offer to purchase the shares held by an individual or a group in the aggregate exceeding 10% of the voting capital of the company or irrespective of the percentage of the voting capital, to take over the management of the company. The regulation provides for an intimation to the Stock Exchange, adequate publicity and an offer to the minority shareholders to purchase their holdings at the same rate offered to the controlling interest. In the event of failure to comply with any of the provisions, the Stock Exchange will withdraw the admission to dealings in the shares of the company in which the party in default has acquired or subsequently acquires a beneficial interest.

The provisions of the listing agreement are flexible and elastic; it has the force but not the rigidity of law. Therefore, its implementation rests on the Stock Exchange as it is primarily designed to regulate relations between the listed company, its shareholders and the Stock Exchange.

The subject of listing requirements has many facets. But, for the sake of brevity, only the essentials are stressed in this article. For this purpose, the booklet published by the Bombay Stock Exchange on "Stock Exchange Listing" has been liberally relied upon. For wider discussion, interested readers may refer to the pamphlet which is a reprint from the Stock Exchange Official Directory.

In the next issue, it is intended to discuss the functional specialization under which the members of the Stock Exchange carry on their business and the types of contracts which they are permitted to enter into.

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There is no functional classification in Indian stock exchanges. In the London Stock Exchange, for example, there was a class of members recognized by the exchange as 'jobbers'. Members registered as jobbers were not permitted to deal for or with a non-member or were required to register the securities in which they wanted to deal. They had to give an undertaking that they would actively offer to buy or sell such securities at a price, binding as to any part thereof, that may be a marketable quantity.

In the New York Stock Exchange, there are 'specialists' who are engaged in buying and selling of a more specific issue of stock on the floor assigned to them. They deal with other members of the exchange and not directly with the public. In recognition of their role, the U.S. government has granted them special tax concessions and bank credit up to 90% of the market value of the security pledged. But this kind of dichotomy is absent in India.

There is, however, a broad classification as 'active' and 'inactive' members. The classification rests on the premise that an active member has paid his security deposit and is actively engaged in the business of buying and selling of securities. An inactive member holds the membership card and only surfaces once a year at the time of elections to the Governing Board. But this class is fast dwindling.

Functionwise another broad classification can also be noticed. Members of the exchange are permitted to deal as (a) brokers acting as agents buying and selling securities for their clients on a commission basis, (b) traders or dealers acting as principal buying and selling securities on their own account for profit or at a loss.

But where a broker deals with his client on a principal-to-principal basis, Sec. 18 of Securities Contracts (Regulation) Act stipulates that he cannot do so unless he acquires in writing the consent or authorisation of such person and discloses in the contract that he is acting as a principal. In other words, he has to tell his client, and the latter must agree, that the securities purchased or sold are on his own account and no third party is involved in the transaction. The contract to be used in such a case is contract note - Form B which contains the legend: ‘contract note issued by Members dealing with constituents as principals’.

Established categories

However, notwithstanding the fact that the bye-laws have not laid down any functional distinction between the members in practice the members of the Exchange do themselves under fairly well established categories such as: (a) commission brokers; (b) floor brokers; (c) taravennivas; (d) dealers in non-specified shares; and (e) odd-lot dealers. The former three require special tax concessions and bank credit. For the last, a member may be granted up to 90% of the market value of the security pledged.

Commission broker

Almost all the members are commission brokers. They execute contracts for sale and purchase on behalf of their clients. They charge brokerage as per the scale fixed by the byelaws. Presently there is no minimum brokerage except the minimum charge of Rs. 5 per contract. The maximum brokerage chargeable is 2.5% of the value of the contract.

Floor brokers

These members who have hardly any clientele of their own execute orders for other members and share, as compensation for their services, the brokerage charged by the authorising members to their clients. They are a dwindling lot.

Taravennivas

These are essentially traders. They select more active scrips and continually trade in and out of the market for a small difference in price. Their economic justification lies in the assumption that they assist in making a market i.e., maintaining a continuous supply of and liquid market in stocks in which they specialize. Perceptive observers of the stockmarket have however questioned this proposition. Firstly it is pointed out that they are active in trading only in those scrips where there is already some activity. In Indian conditions their role in creating a market in dormant scrips is open to question. They are not interested in scrips where price fluctuations are marginal. Secondly they tend to follow the market in which the market is moving.

In a bull phase their activities accelerate the rise in prices and in a bear phase they speed up the fall. They cannot be halted on this account because they are not ‘jobbers’ as such. It is understood in London or ‘specialists’ who operate in New York. It is noticed that where these traders operate, the markets have attained certain breadth of basis, Bombay, Calcutta or Delhi, and the markets have remained narrow where they are absent, as for example in Madras or Bangalore.

Dealers in non-specified shares

There are some, brokers who specialize in buying and selling shares which are not on the active list, both on their own account and for their clients. There is no bar on them in dealing in active shares also but they generally shun speculative activity.

Odd-lot dealers

Units of trading (generally known as market or trading lots) in each security are fixed by the Board having regard to its face value. According to the byelaws, all transactions have to be made in multiples of the trading unit unless an odd lot is stipulated when the bargain is made. Presently, under the government guidelines the market lot is 100 in the case of shares of the face value of Rs. 10 and 10 where the face value is Rs. 100. Odd lots arise when companies issue rights or bonus shares and cannot avoid allotment of
of lots, or where in oversubscription of new issues, shares are allotted in gilt lots amongst the applicants.

Some years back, the brokers at Hill & Salvi were buying and selling gilt lots. They bought "odd" lots at prices lower than the ruling price for full lots, consolidated them into full lots and sold them at a profit. They not only relied on commission but made extra profit on the difference between their buying and selling price. But this service is now available to the investors. The art in the business has resulted in many brokers abandoning this type of activity as not sufficiently lucrative. As a result, there is no ready market available for these odd lot holders.

Recently, the UTI tried to help but is understood that the scheme has shown much progress. The High

Market Committee has sought to solve the problems by recommending the companies to issue bonus and "odd" lots. This suggestion now needs implementation at all levels. A computerised matching of the odd lots and offers, its success can be judged only after some time. There is no suggestion made by a company to create a trust which would collect odd lots, consolidate and market in and distribute the proceeds, deducting expenses, amongst the owners. The problem of disposal of latter is genuine and deserves attention.

dilwara or financier

Simple terms, the role of a Bad-

alla (also termed Badalwalla) or a financier may be described as lending the money by taking up delivery on debt of the obligor on behalf of those who wish to try over their purchases to the next element, or loaning securities to the holder when it is short by giving delivery on behalf of those who wish to carry over their sales. In the former case, he earns "contango" (or badali) charges and in the latter "backwarda-

The use of the stock is loaned for a set period of two or three weeks. The loan is fully secured and the firm is governed by the technical ability of the market and the ruling rate of interest. The dilwara is the capital of the business where carry transactions are permitted. Later this article, its mode of operations are more fully discussed.

Bilateral

Bilateral laws define "archivist" as 'nisting the business of buying or selling securities in one market with the benefit of reversing such transac-

The beginner's brief

Business depends on the number of securities dealt in common on more than one stock exchange and the existence of ready means of communication. At present only a few members who have ready trunk telephones, telex and teleprinter facilities (otherwise also known as lineprinters) specialise in this category. The Reserve Bank of India and the Stock Exchange of India have promulgated the guidelines of the major exchanges through electronic equipment and simultaneous display of price movements of selected securities in major centres. It is expected that with this development, the markets will broaden and first steps towards an integrated national market will have been taken.

Underwriters

A few brokers have specialised in underwriting and marketing of new issues. Before the financial institutions appeared on the scene, underwriting was mainly done by brokers and banks in the private sector. In the dog days of the stock exchanges, their role had shrunk and hardly any worthwhile underwriting was done by them. Those were times when the then chairman of ICICI, the late Mr. G. L. Mehta remarked that "underwriters have become undertakers". In recent times, they have been more active and their role in the securities market is of many new issues has not been inconsiderable. At present, under the government guidelines, underwriting is permitted to be done by stock brokers who are members recognised stock exchanges, public financial institutions, banks and approved investment trusts and companies.

Security dealers

The list category is that of security dealers. They specialise in buying and selling gilt-edged securities, i.e., securities issued by the Central and State governments and statutory public bodies like municipal corporations, improvement trusts and electricity boards. The market is essentially on the over-the-counter market and each transaction is separately negotiated. There are about half a dozen active firms of security dealers in Bombay and the number elsewhere is more limited. A security dealer is required to be on the approved list of the Reserve Bank of India before it deals with them.

Trading in securities

Once the securities are listed, members can technically do business in them. But usually the stock exchange does not permit members to do so till such time as the issuing company certifies that all share certificates have been posted to the allottees. In times of frequent new issues activity, a lot of uncontrolled trading takes place mostly at a premium but in India such activity is not recorded and reported to the exchange as it is not according to law. All these transactions are brought into account after the official permission is given.

In the US there is a system of entering into transaction on "when issued and when distributed" basis i.e., for delivery and payment when issued or distributed as determined by the exchange. There is a syndicate which advocates a similar procedure in India. It is urged that trading in the shares of a company may be permitted after the prospectus is filed with the Registrar of Companies. The strongest argument in favour of this proposition is that the market price of the share may be determined by the interplay of market forces and the premium over the issue price may be determined by the competing forces of supply and demand. Presently the premiums reported by the newspapers which the new issues are stated to command are based on information gathered from persons whom they consider active in the business. But the information is not always authentic and tends to mislead unwary investors.

Types of contracts

The Securities Contracts (Regulation) Act, 1956 defines a contract to mean a contract for or relating to the purchase or sale of securities. Of the different contracts which a stockbroker enters into with his clients, one of the most important is a "spot delivery contract" and leaves the rest to the stock exchange, which, according to the Act means "any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities in India."

Bills of a recognised stock exchange define the other types of contract as under:-

(i) For "hand delivery" i.e., for delivery and payment within the time or on the date stipulated when entry into the bargain which time or date shall not be more than fourteen days following the date of the contract.

(ii) For the "clearing", i.e., for clearance and settlement through the clearing house in the manner prescribed in the bye-laws and regulations.

(iii) For "special delivery" i.e., for delivery and payment within any time not exceeding fourteen days from the date of the contract as may be stipulated when entering into the bargain and permitted by the governing Board or the president.

Spot delivery contracts

According to the Act this is the contract which provides for the actual delivery of securities and the payment of a price, therefore, either on the same day as the date of the contract or on the next day, the accuracy of the dispatch of the securities or the remittance of the money thereof through the post being excluded from
the computation of the aforesaid period if the parties to the contract do not make delivery of the same within 14 days from the date of the contract. Normally members of stock exchanges do not enter into spot delivery contracts. But whenever there is a crisis and the Governing Board of the exchange is forced to take measures to curb excessive speculative trading, such corrective measures as prohibition of fresh trading or total suspension of normal trading, spot delivery contracts have permitted to provide a market for genuine investors.

Where stock exchanges operate, it is prohibited to enter into contracts for the sale or purchase of securities in the specified state or area except through members of a recognised stock exchange. But Section 18 of the Act excludes spot delivery contracts from the operation of this rule. This would mean that even in places like Bombay or Calcutta where stock exchanges function, two persons can exchange securities by the simple act of oral agreement without the intervention of a stockbroker.

**Hand delivery contracts**

The definition of a hand delivery contract under the bye-laws is clear and simple and needs no elaborate clarification. At the time of entering into such a contract, it is understood that the share will be delivered and payment made within 14 days from the date of the contract. However, two points deserve to be noted. Having regard to the multiplicity of the contracts entered into by the members in different exchanges, it is impracticable to settle each contract separately. Therefore, the programme is so arranged as to fix a single day for settlement of the contracts entered into during a specified period. In some exchanges, this period is of one week and in some others like Bombay it is a fortnight.

The second point which deserves notice is that a contract need not always be terminated by delivery and payment. It is possible to terminate them by a cross contract i.e. a purchase contract by a sale and vice versa. As the reverse contract is done in the market and not necessarily with the same party, while the first party will either receive or pay the differences in prices, the second may either take or give delivery at the end of the settlement period.

**Clearing contracts**

Under the bye-laws, these contracts are settled through the clearing house in the prescribed manner. These were known as forward contracts in popular parlance. Basically these were also hand delivery contracts but at the end of the settlement period, the buyer or the seller had two options open to him if the contract was subsisting and he had not terminated it by a cross contract during the period. He could either take or give delivery and carry forward the purchase or sale to the next settlement. If he was a buyer, he could arrange to carry over his purchase either with a seller who similarly intended to carry over his sale or with a call writer, the latter taking delivery on his behalf. In either case, the mechanism adopted to terminate the existing contract at the making up price and simultaneously enter into a reverse contract at the same price with the contra charges loaded to it. An example will illustrate the position clear. Suppose broker A has been instructed by his client who had purchased 100 TISCO shares at Rs. 1,400 per share to carry over his purchase to the next settlement. The day before the badla season, the stock exchange announced the making up price of TISCO at Rs. 1,450 per share. Assume that during the badla session the contra charges for TISCO are being quoted at Rs. 15 per share and broker A has arranged with the call writer B, the crore-vitter. In such a case, the arrangement adopted will be for A to sell his 100 shares to B at Rs. 1,450 per share for the current settlement and simultaneously enter into another contract with B to purchase the same lot of 100 shares at Rs. 1,465 per share to be settled at the end of the subsequent settlement period. On January 29, 1983, the government decided to empower the Governing Board of the major stock exchanges to permit them to extend the period of hand delivery contracts in certain specified securities by further periods of 14 days each with an overall ceiling of 90 days. The methodology adopted for settlement of the contracts relating to the specified securities is more or less the same as in the case of cleared securities.

Presently, therefore, trading in the stock exchange is being carried on the following basis:

(a) Hand delivery contracts in specified securities where the performance is extended beyond the period of 14 days but within the overall ceiling of 90 days.

(b) Hand delivery contracts in "unspecified" securities as understood within the bye-laws. In popular parlance, the first type of contracts are known as forward contracts or "voyda" in Gujarati.

**Business hours**

The stock exchange trading ring is open for business by the members on all days from 9 a.m. to 2 p.m. except on public holidays under the *Negotiable Instruments Act* of 1881 and such exchange holidays as the Governing Board may declare in advance from time to time. During exchange holidays, while the ring is closed for business, the office of the exchange remains open for members of the public except during Christmas holidays between 25th December to January 2, when only a skeleton staff is on duty. The ring is also closed for business on all Saturdays except when specifically kept open due to exigencies and on Monday following the bank holiday if the same takes place, either on the preceding Friday or Saturday. There are special trading sessions on the *Draft and Budget* days.

There is no uniformity of trading hours in the different stock exchanges in India. Many of the other exchanges open only after 12 noon when they come to the opening of the market. Bombay, the government has been pressuring the exchanges to keep the trading sessions open for longer hours but they have not found it possible to do so on account of pressure of work. In Bombay, for example, even with full computerisation it has not been possible sometimes to settle the contracts within the time schedule fixed in the programme. Brokers fear that with increased hours and increased volume, the system might be thrown into confusion.

Even to the floor of the exchange is restricted. The persons allowed admission are a member, his partner or his authorised clerk. All these are identified by the badges which the exchange issues to them. A suspended member or a member who has been expelled or declared a defaulter is denied entry along with his partners and authorised clerks. All the persons who are admitted are eligible to do business, but bargains can be concluded only by or on behalf of the authorising members. The stock exchange provides them with distinctive official pads for noting down bargains made by them. These are important documents as they constitute books of original entry and are invaluable in case of disputes. Bargains which are not extended therein are not recognised in arbitration.

The bye-laws permit members to enter into bargains off the floor, (over-the-counter) before or after the hours of the trading sessions but they are prohibited to make offers of purchase or sale, either on or off the floor of the exchange before or after the hours of trading sessions. Calling out of prices, bids or offers or trading in the street or at the entrance of the stock exchange is also not allowed. Nevertheless, one sees quite often the unidentifying spectacle of people gathering in the evening at the entrance of the stock exchange. Authorities have tried in vain to control this herb-trading but with little success. Heavy fines have been imposed and suspension orders have been passed with little effect. Penal action has been found to be of no avail and the only remedy appears to be an increase in the trading hours and adoption of more sophisticated and efficient machinery to settle the transactions.

V.D. Sonde

FORTUNE INDIA 45 SEPTEMBER 1988
rule 15 of the Securities Contracts (Regula-

tion) Rules, requires every member of

recognized stock exchange to maintain

certain books of account and documents.

some of them are to be preserved for five

years and some for a period of two years.

those in the first category (i.e., to be main-

tained for five years) are the following:

(a) register of transactions (sauda book);
(b) clients ledger; (c) general ledger; (d) jour-

nals; (e) cash book; (f) bank pass book; and

(g) documents register showing full particu-

lar of shares and securities received and

delivered.

The following documents have to be

maintained and preserved for two years:

(a) members' contract notes showing details of

all contracts entered into by them with other

members of the same exchange or counter-

parts or duplicates of memos of confirmation

issued to such other members;

(b) counterfoil or duplicates of contract

notes issued to clients;

(c) written consent of clients in respect of

contracts entered into as principals.

SAUDA BOOK

The names of the books and documents are

succinctly evocative and it may not be

necessary to explain their significance. In

addition, there is the audited block in

Bombay which is important as the book of
goal entry. These are small handy note

pads which bear the superscription of the

exchange issued to the members according to

their requirements under the signature of

the secretary and are utilized to record the

transactions as and when they are done in

the ring.

The basis of these pads members

write their sauda book. They send the or-

iginal sheet to the exchange's computer- for

verification of the transactions with the

boxed carbon copy serving as their sauda

book. No separate contracts are issued to

the other members. The checked and

verified sauda sheets themselves serve

this purpose. In smaller exchanges like

regions, members exchange contract

notes inter se and use memos of confirm-

ation for verification of these transactions.

Rule 12 lays down that every member

will get his account audited by a char-

tered accountant whenever such audit is

required by the Central government. Though

the wording of the Rule suggests a selective

approach in individual cases, a year or two

back the government issued instructions that

all brokers will be audited by a chartered

accountant and a certificate to this effect must be

furnished with the stock exchange.

At first it was stipulated that certified
copy of income and expenditure account and the balance sheet should be

furnished with the exchange. On representations that this requirement may disclose to out-

siders the financial viability of a broker and

may also jeopardise the confidentiality be-

tween a broker and his client, it was

modified to lay down that every broker

must file with the exchange a certificate to

the effect that his accounts have been

audited by a chartered accountant.

The Institute of Chartered Accountants on

the sauda side have issued appropriate instruc-

tions to their members on this behalf; the

requirement is in addition to the tax-audit

required under the IT Act.

ARE BROKERS GUILTY OF ...?

Government was concerned with the

increasing number of complaints received

from investors that shares purchased

were not being delivered even days

after payments were made. The tone of

the complaints was that brokers were

skimming, overcharging clients for luring

their own speculative activities. This

allegation was sought to be strengthened

by the complaints that even the proceeds

of the sale of shares were not regularly remit-

ted.

The brokers on their side refuted the alle-

gation and claimed that they were also

victims of the settlement procedure in the

exchange. They alleged that they are not

finder the brokers charging com-

mission for putting through the transactions on the

floor of the exchange on behalf of

their clients. While they had to advance

payment in cash to their clients to

be able to adhere to the market

schedule, they could only make any

payment to them after they receive payment from the market

for the shares sold by them. They claimed

that not all the clients were scrupulous

in making payments in time and as they risk

being declared as defaulter if they do not

adhere to the payment schedules in the

market, they sometimes had to make the

necessary adjustments in their accounts.

Once a broker point out that sometimes they have

to share the responsibility for the mis-

behaviour of the sub-brokers.

SUB-BROKER REGISTRATION

Under the present system, a sub-broker is

a person who on payment of a certain

sum to the broker and executes their orders through a member

of the stock exchange. Though a sub-broker

normally works with one broker at a time,

a person occasionally finds himself to be in

charge of the exchange. He is more or less a

free lancer. However, the conduct for the

brokers executed on his behalf are issued by

the broker. The trust acts as a conduit be-

tween the broker and the client.

While the broker shares the responsibility

for the transactions vis-a-vis the market, he

introducing sub-broker vouches for the

client and the brokerage is shared between

them. Many of the difficulties arise out of

the unregulated role of the sub-brokers. For

the final analysis, the responsibility lies

with the broker as he has issued the contract. This

state of affairs is sought to be remedied by

the Capital Committee which has recom-

mended the registration of sub-brokers

with adequate safety deposits being col-

lected from them.

There are also brokers in different parts

of the country who operate through mem-

bers of the recognized stock exchange and

issue their own contracts to their clients. The

Capital Committee report contains proposals

for licensing them and regulating their pre-

viously uncontrolled activity.

It is the allegation that brokers are using

the moneys of their clients for their own

speculative activities which has persuaded

the government to issue the general direc-

tives for audit. It is hoped that audit by a

member of the Institute of Chartered

Accountants will inspire confidence in the

minds of investors that their moneys are

not being misused. Though initially there

was some resistance in stockbroking circles

to this move, it has now gained common

acceptance at their hands.

FUNCTIONS OF BROKERS

It is now evident that the functions of a

broker are to bring the buyers and sellers of

securities together and to earn his brokerage

fee for services rendered in this behalf. For

this purpose he has to be a member of a discri-

minated organization, follow its rules and

regulations as well as to proceed under the

law. The procedure laid down by the govern-

ment is that the dealings of the broker are

in accordance with the securities permitted by it and generally con-

duct himself in a regulated manner.

It is because they have to conform to this

discipline and, therefore, stockbroking involves the exercise of mental faculties that

the brokers often envy that they are carrying

on a profession and by practice and con-

duct they are professionals. But this claim

of a equals to the profession in the sense

that a stock exchange card can pass to a

person by inheritance and strict professional

qualifications are not insisted upon persons

who inherit the membership.

In this position, however, it is undergoing a

welcome change and majority of the new

members applying for admission, besides in

Bombay, are academically well qualified

and in the age group of 25 to 35.

How does then a prospective client approach a broker? Normally a broker in-

vitates to a client who is not known to

him. He would require an introduction par-

ticularly if the client happens to be in the

residential area. Of late, brokers in the major

area are using of late, brokers in the major
stock exchanges are reported to be refusing business in small lots. As their hands are otherwise full on account of the hectic activity presently prevailing in all the exchanges, they find it unconomical to entertain smaller business. It is however expected that this will be only a temporary phase. Steps are being taken to increase the membership of existing exchanges and to increase their number.

There is no settled procedure for placement of orders by the clients. More organised brokers may take the orders in writing but generally orders are taken verbally from the clients or on telephone. It all depends on the trust and relationship between the brokers and their clients.

The Retail Committee has suggested that the brokers must maintain an order book wherein the orders are noted in the order of receipt and the execution property documented. Brokers point out that the suggestion is impractical and when orders flow in, whether in writing or verbally, it is not possible to maintain this documentation properly with the limited staff at their disposal. But the suggestion has merit and has been made in the interest of the investors. It is hoped that it will be implemented in course of time.

TYPES OF ORDERS

When placing an order, it is necessary for the client to be specific. If the has complete faith in his broker and his judgement, he can put in an “at best” order. An “at best” order means that the security may be purchased at the cheapest possible or sold at the best price obtainable. If the client has studied the movement of the prices of the security which he wants to buy or sell, he can place a “limit” order. In this type of order, a restriction is applied to the price. In the case of a purchase order, the broker may be instructed to withhold the order price on a specified price and as per contract not to sell below a stated price. There is a third type known as “stop loss”. This arises in a situation where the client wishes to limit his loss and instructs his broker not to sell below a fixed price.

These orders are registered in the broker’s office either by the broker himself or by an authorised clerk. Orders received before the opening of the market are noted down on a sheet and taken to the floor for execution and orders received during the time when the market is open are transmitted to the authorised persons in the ring. The execution of the order is done by the broker personally or by his authorised clerks. There is an intercom facility available between a broker’s office and the ring. Periodically the authorised person rings up his office for frequent calls if any and if the office wants to communicate with him, a connection flashes the number on an electronically operated board which gives an indication to the person in the office to contact him. The stock exchange issues authenticated notice books (called sauda books) to the authorised persons to record the transactions. These are important as they constitute the basic record on which future entries are based.

In Bombay, on working days the market is open from noon to 8 p.m. The market is not open on Saturdays, Sundays and all days declared as holidays under the Negotiable Instruments Act. However, some exchange holidays are observed. It is also remains closed for settlement work on Mondays following the elders days in the forward section. On occasions when the settlement work in the cash section falls in arrear, no trading is done.

As Bombay is the main exchange and the price setter for securities in the country, this pattern of working has come in for severe criticism at the hands of investors and other stock exchanges in the country. But the sheer volume of business and inadequate infrastructural facilities have contributed to this state of affairs. Informed circles must make adequate efforts and lend a helping hand for improvement of the situation. Without appreciating the position, a couple of years back instructions were issued to the exchanges to restrict holidays and increase the hours of work. The instructions were complied with for some time, followed by a back-to-square-one position within no time.

THE TRADING RING

The trading ring is divided into various trading posts. A broad division is made between the forward section and the cash section. Each section is further divided into various trading posts. These are designated places where buyers and sellers in specified securities congregate. While executing the order of a client, all that the authorised person does is to approach the persons standing near the post and strike the bargain. As explained earlier, each member is authorised to have a few clerks (either in his employ or having his 'badge') to make a deal on his behalf. Therefore, on any working day, there will easily be a couple of thousand persons congregating at the trading ring shouting and gesticulating.

To acquaint the broker who sits in his office to accept orders from his clients and to keep in touch. There is a movement of prices in the ring, the stock exchange has arranged an internal radio service on which after the opening rates are broadcast in selected securities. movement of prices at regular intervals are given, with the service closing at the end of the session with the broadcast of the closing rates. This network is also utilised by the exchange to transmit information received from companies in respect to declaration of dividends, bonuses and such other price-sensitive events.

A warning bell is rung fifteen minutes before the opening and the closing of the session. On the sounding of the opening bell after the warning bell, the session is open for business. The session continues till the sounding of the closing bell. Admission into the ring is regulated by distinctive badge for members, their partners and authorised clerks. Unless otherwise stipulated, when entering into a transaction, if a buyer or seller makes an offer the price quoted remains good for a matter of minutes. In extreme cases, omissions, delays or errors are made in matter of transaction and the price of securities dealt in the ring are collected by three quotation clerks of the exchange. The opening and closing quotations are important. Variations are also noted down. Complaints are often received about the prices noted in the circulars at variance with the officially listed quotations. The difference may arise for two reasons. Brokers include in the price the brokerage charged by them while the official quotation is not of this figure. It may also be due to the fact that the quotation clerk has failed to record the rate. There is a proposal to feed the information by a broker direct into the computer through appropriate terminals placed in the ring, but it will take time to implement the same. What is required to be noted here is that the governing board or the president has the power to expunge a quotation if there is adequate proof to show that it is inconsistent with the market value of the security and is not the result of a bona fide bargain.

On his return to the office after the close of the market, the broker or his authorized clerks who have transacted the business on the floor on his behalf transcribe from the sauda books all the transactions into the day's report and the book consists of the base material on which the broker records his transactions during a given settlement period. It contains details such as the code numbers of the securities purchased or sold, the code numbers of the brokers from whom purchases or sales have been made or to whom the sales have been made, the quantity of shares purchased or sold and the rates at which the transactions have taken place.

Computer sheets are prepared on the basis of the book and are sent to the stock exchange for verification of the transactions as a basis for settlement. Settlement takes place on the same day when the transactions have been made. The broker himself is informed of the implementation of the transactions given by him. While some brokers keep separate sauda books, some others utilise the duplicates of the sheet as the basis for purpose. In a well-regulated broker's office, the oral information is followed by confirmation in writing. Immediately thereafter a regular contract note is sent.

CONTRACTS

There is no compulsion in the bye-laws to issue a contract to the client. The regulations however lay two types of contracts, one of which is issued when the broker acts as an agent and the other when the contract is between the broker and the client. It must be realised that when a client wants to either purchase or sell shares, a broker can enter into a contract with his client for a price. On completion of such a contract, the contract note is signed by the broker and the client. For a short period, brokers are required to submit to the exchange a material containing a statement that the broker is either acting as an agent or dealing for himself and the client. No action is taken against a broker unless he has entered into a contract with the client for the purchase or sale of a share. The objective behind this
stipulation is to assure the client that the transaction is done at a competitive price. As there is no compulsion, many brokers do not issue the contracts but follow the written confirmations with monthly bills giving all the details. This practice is generally adopted as it is felt that in this manner stamp duty may not become payable. The stamp duty authorities do not agree with this view. Besides, this is a dangerous practice as in the absence of a contract, neither the broker nor the client will be able to take recourse to the arbitration procedure under the bye-laws. The Peal Committee has highly stipulated that issue of contracts must be compulsory.

In one of the previous issues of FORTUNE INDIAN the settlement procedure in the Bombay Stock Exchange was explained in considerable detail. Nevertheless, it is now being summarised as it is relevant to do so at this stage. Mention was made earlier that every day copies of stock books are sent by every broker to the stock exchange for settling his transactions recorded. This process continues during the settlement period. The day prior to the day fixed for "bada", every broker will have with him a complete list of the securities purchased and sold by him during the period. On that day, the broker also makes up his accounts for the period and gets an idea regarding his position vis-a-vis his clients and also the other brokers in the market. He is also in possession of information regarding outstanding contracts both for purchases and sales in individual securities. At that stage, he checks up with his clients as to the quantum of shares which the latter would like to contract which his clients desire him to do.

Thousands of transactions would have taken place between the brokers inter se at varying prices during a settlement period. As accounts are made up between them at the end of every settlement period, it is impossible for them to determine their inter se liabilities on the basis of the rates at which the transactions have taken place.

This is commonly known as "bada" work and a substantial part of the work is accomplished between the brokers on the day earlier to the bada day. But the rates at which the contracts are to be carried over are fixed in the open market session on the next day as per the programme fixed by the stock exchange.

Take delivery of or to give delivery and the number of shares in which the contracts have to be carried forward. In other words, the brokers separate list of shares to be delivered or taken delivery of and the number to be carried over to the next settlement.

Immediately thereafter he makes sure that his clients hand over to him the shares which they have sold and have to be delivered and pay the amounts to him for the purchases which they have made. He also contacts other brokers to find out with whom he can make arrangements for carry over to the next settlement the outstanding contracts which his clients desire him to do.

In order, therefore, to simplify the procedure, the device of "making-up" prices is made use of. It becomes much easier if, in the place of varying prices, the amounts are made up by arriving at all contracts at a single price and this is what the mechanism of "making-up" price does. As between the brokers, all transactions (crossed out or carried over) are settled at the "making-up" price for each security.

So on the evening prior to the bada day, the Executive Director of the stock exchange intimates to the brokers the making up prices for each of the securities on the forward list and also indicates the shares in respect of which there will be "no delivery" at the end of the ensuing settlement. The position of "no delivery" arises as the concerned company would have intimated that it would be closing its transfer books from a certain day and if delivery does take place, there would be no time for the purchasers to lodge them for transfer before the books close. It would be obvious that the period for which this situation arises is more than one settlement period. The brokers then carry over the transactions in the particular security keeping this fact in mind and the bada rate would naturally be higher. This is also known as "bada" with bada in Gujarati.

V.D. Sonde
Inside The Stock Exchange - 2

Books of Account - 2

Settlement procedure
The settlement procedure which is carried out by the stock exchange starts after the bids session takes place, when the brokers in the open market finalise the bids rates. Technically the bids rates are negotiated by individual brokers and depend on the demand and supply position. However, over the years a practice has developed whereby a few sessions watch the position in the beginning five or ten minutes of the session and having gauged the rates for the leading stocks rule an announcement and brokers generally follow the rates fixed by them. This is known as giving the “toke” in Gujarati. This practice is adopted as the bids session is normally of half hour duration. “Bids rates” are the rates charged by the brokers for covering orders which are placed with them.

The orders are then verified and finalised through the computer of the exchange. It is then ready with all the material to give the brokers information to prepare a balance sheet of their financial position of the transactions entered into by them. The information is fed in three ways. The brokers are given a statement which allows the amounts receivable/payable on contracts in individual securities which have either been terminated during the settlement period or carried over to the next period and the amounts receivable/payable for securities sold or bought which result in delivery. The totals are struck and net position either payable or receivable is indicated. A statement showing the margin payable on the contracts carried forward to the next settlement is also given. Finally, brokers are given a report on the transactions in each of which the brokers undertake the shares for delivery to the clearing house or receives the same from it.

On the basis of the financial statements received from the brokers, the computer compares the balance sheet which shows on the debit side, the amount payable by him for the securities sold or bought which he has purchased and is delivering. The total is struck and net position either payable or receivable is indicated. A statement showing the margin payable on the contracts carried forward to the next settlement is also given. Finally brokers are given a report on the transactions in each of which the brokers undertake the shares for delivery to the clearing house or receives the same from it.

The settlement of orders which are placed with the brokers is known as the clearing house, which is run by the Stock Exchange. As an agent of the stock exchange, it takes three or four days to process the settlement and get ready to make payments and deliver contracts to the brokers who have to receive them. As soon as they are ready so, it seeks the permission of the exchange and the brokers to make the final payment to their clients and hand the shares over to them.

Standard price
There is no much difference in the settlement of shares on the cash list which also includes securities. The same system of verification of the transactions is followed. At the end of the settlement period, a complete statement of all matched transactions is given to the members. In a simplified form, the transactions might have been crossed out by reverse brokers. In view of the multiplicity of transactions, it is difficult to match the delivering and receiving parties with the corresponding parties. To obviate this difficulty, the method of calculating the differences in a standard price is adopted. This is more or less of the same character as the “making-up price” in the specified group except that the “Executive Director” does not fix the rates. The “standard price” of a security is generally worked out as the weighted average price of all matched transactions in the particular security.

The final statement would indicate the total debts (to deliver) and the total credits (to receive) in each security for each member. The net position is then ascertained and matched against the market. For example, in Clutches, if a member has a sale position of 200 shares and a purchase position of 500 shares, delivery order for 500 shares is prepared on the basis that he is delivering the shares as well as receiving member) and the balance 300 shares to be delivered is matched against market i.e., against one or more members who have to take delivery. It is clear that the sum total of shares to be delivered will be equal to the sum total of shares to be received in each security.

Money statement
As deliveries are executed at the standard price which will be different from the contracted price, differences arising from margin (either payable or receivable) are worked out. These differences along with the details of delivery and receive orders and the payments resulting thereto from and the compulsory carry forward of transactions, if any, due to non-delivery in the current period are then printed together in a specified form. This is known as the money statement. It also shows the net amount either payable or receivable. The amount is then carried separately either as a pay slip or as a receive slip and given to each member. The clearing house is supplied with a summary of all the pay and receive slips issued to each member.

Unlike in specified shares, the clearing house handles only the money part, in the case of cash or non-specified groups. Physical deliveries of the shares as specified in the delivery orders are handled by the brokers themselves. On a day designated for the purpose known as “settlement day”, the deliveries are effected from office to office. If, for any reason, a delivering member cannot give delivery of the shares as indicated in the delivery order, he gives a credit note to the receiving member. Simultaneously the two concerned members enter the same transaction as a “renewal transaction” at the standard price in the next settlement. Once the physical delivery is over, each member prepares a balance sheet from where he forwards the details of the pay/receive slips and the credit/debit notes relating to cases where delivery could not be taken place. The net amount is then payable or receivable by the member. On the designated pay-in-day which is normally the day following the settlement day, all the members who have to pay or receive their balance sheet send their cheques and those members, who have to receive, send their checks to the clearing house.

After a couple of days when the cheques are cleared, the clearing house declares the
pay out and credits the respective accounts of members who have to receive money as per the drafts submitted by them. At this stage, the settlement procedure is complete as far as the exchange is concerned and it is then left to the brokers to interact with their clients.

**Delay in delivery**

Investors often complain about the delay in the receipt of the proceeds of the shares sold by them or the shares purchased by them. These complaints, as far as Bombay is concerned, are not generally made in respect of the shares in the specified lists. They mainly relate to transactions in non-specified shares or odd lots. The reason lies in the system adopted for settlement of transactions in the two groups.

From what has been said above, it will be clear that the exchange takes on itself the responsibility for settling the transactions in the specified shares group, in totality. Both the money transactions and delivery of shares are effected through the medium of the clearing house. Meanwhile, in this manner, on certain dates (i.e., sales without physical possession of shares) are permitted and when sales are made for delivery, a broker ensures that the certificates are in his hand at the end of the period.

If for any reason, the client cannot deliver the shares which were intended to be originally delivered, the transaction is officially carried over to the next settlement. The broker knows that if he shows the delivery (i.e., does not carry forward) and fails to deliver on the pay-in-date, the exchange will purchase the shares in auction at his risk and cost. Therefore, normally delay in associating with the clients in these cases should not occur. If it does in some cases, it may be attributed to excess in his office working or due to the intervention of the sub-broker.

However, delays are frequent in the non-specified group particularly relating to the non-receipt of shares purchased by an investor. There is criticism that the system of settlement adopted in Bombay often leads to speculative activity of the type in vogue in specified shares, without the regulatory measures which are operative here. The criticism is not without justification.

It is, however, argued that delays do not take place merely because the shares which have been sold are lying with the companies which have been lodged for transfer. It is stated that such sales take place as investors want to take advantage of the rising high market price of the particular security which may not sustain by the time the company returns the certificates.

It is also pointed out that investors, particularly in the non-specified areas, send the certificates to the broker only after they intimate that the sale has been effected. Then follows inordinate delay in the broker sending the BIDs to the client, his returning them duly signed along with the certificates, mistakes arising in the client’s filing the forms, property etc. It is pointed out that this eats into the time schedule of the settlement.

These difficulties are real but at the same time, the fact of speculative interests taking advantage of the situation cannot be ruled out. It may be mentioned that the exchange is aware of the position and attempts to control the evil within acceptable limits. The clearing house has in many cases either given a certain degree of time to the clearing member to make the settlement or has relaxed the settlement conditions.

**As a general rule, the broker tend to be at the mercy of the seller.** The rules provide that the clearing member could return the securities if the seller member is unable to deliver and seek the help of the stock exchange to buy the shares in auction at the risk and cost of the broker. Normally, the certificate is not taken as it is possible that on opening the auction the broker may see the shares in another leg. Therefore, tend to advise each other.

While the exchange has control over the settlements in these two groups, i.e., specified and non-specified, in odd lots, foreign shares, and foreign securities which constitute the third group, its role is minimal and may be confined to supervisory functions. Foreign securities are also otherwise known as exempted securities.

Under the by-laws members are permitted to deal in any security or securities listed on any other stock exchange. A Bombay broker, for example, may accept orders for purchase or sale of any security listed in Delhi, though the same is not listed in Bombay. In such a case he will execute the order through his counterparty in Delhi. If he cannot get a matching order in Bombay itself. In the latter case, he will charge his brokerage on the transaction entered into in Bombay. In the former, the investor will have to bear in addition the brokerage of the Delhi broker. The advantage to the investor is that he deals with the local man.

In this group, the role of the exchange is limited to verify the transactions and give to the brokers fortnightly security-wise lists of matched transactions. The procedures of settlement are as follows: Transactions done during one fortnight are normally settled between Monday and Saturday. The seller may deliver till this time. The buyer does not exercise the option.

Contracts outstanding at the end of the fourth fortnight are deemed to have been terminated by the closing rates on that day and all disputes regarding the settlement of such contracts are decided accordingly. However, as discussed earlier, the market for odd lots is now practically dormant.

Investors are sometimes puzzled by the expression ‘bids and offers’ used in stock market circles. What is required to be realised is that these expressions do not occur in the Bombay quotation list. The Bombay market is the most active in the country and normally shares of many listed companies are traded, if not regularly then on occasion. Therefore, the exchange gives quotations of only those transactions which have actually been completed.

But some of the smaller exchanges adopt the practice of giving quotations of the rates at which purchases have been bid or sales have been offered. This is a good practice which informs the opposite party that at that price there is a customer who is ready to either sell or purchase. It is hoped that all exchanges follow this practice particularly when a recent study undertaken by the Bombay Stock Exchange has revealed the information that shares of a substantial number of companies have never been traded even once after listing.

V.D. Sonde
DEFINING THE TERMS

Defining the regulatory measures in the by-laws designed to contain excessive speculative activity, it will be convenient to clarify the meaning of some terms which are prone to change on the stock exchanges.

Bull: The process of subsequent buying or selling to establish a fresh price level holder of 100 shares at Rs. 100 by buying a single 100 at Rs. 100 would result in 200 shares held by the seller. Sellers can also average either side of the market.

Short Sale: An impertinent applicant for new issues of capital stock.

Underwriting: Any person or the date at which the Reserve Bank of India fixed the price of the shares.

Act: Requires that such shares shall first be offered to the existing shareholders. This is known as an offer of rights and it has marketable value.

Selling out: The reverse of buying in.

Ex & Cum' rates: Often a question is asked as to what is meant by 'Ex' and 'Cum'. A company's dividends are either a purchase or sale and at what point of time a purchase or sale is marked 'ex-dividend. Ex and Cum are well-known expressions in the stock exchange. Under the Companies Act, dividends and other benefits accrue to a shareholder whose name is registered with the company on the date when the Register of Members is closed for the purpose. Nevertheless, when the Registrar makes a transfer of his share to a transferee, he becomes a trustee of the dividend, rights and other benefits. The system adopted by the stock exchange for such transactions is that the dividends and other benefits are paid 'ex' from a certain date. It is not necessary to say that the expression 'cum' is a position from Latin meaning with and the expression means 'in'. Normally all transactions in the stock exchange are 'cum' dividends, rights etc., but they are marked 'ex' from a specific date indicating merely that purchasers have not taken delivery before that date and will not have the time to realize the shares with the company. The date of the closure of the Register and thus entitle to the benefits. The purchaser after that date will not have the time to realize the shares with the company and thus be entitled to the benefits. The purchaser after that date will not receive the dividend, rights etc., but they are marked 'ex' from a specific date indicating merely that purchasers have not taken delivery before that date.
transactions will be ex-dividend from the first day of the settlement period with the stockbroker. The stockbroker will then deliver the shares to the client. In practice, the shares are marked ex-dividend, dividends etc.

There are 19 clear days available for the purchaser to complete the transfer formalities and lodge the shares with the company. Sometimes it so happens that the time available is inadequate and in such cases, the broker gets the shares transferred to his name so as not to lose the benefit and then transfers them to the client thereafter.

On the day on which a security is quoted ex-dividend the ex-dividend value of the dividend is deducted from the market price. In the case of right shares and bonus shares, the working is done as under:

<table>
<thead>
<tr>
<th>(a) Right shares</th>
<th>Issue at 2 for 3</th>
<th>Market price, etc Rs. 300 per share (cum-right)</th>
<th>Face value Rs. 100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of 2 shares</td>
<td>Rs. 600</td>
<td>Value of 1 shares</td>
<td>Rs. 300</td>
</tr>
<tr>
<td>Value of 5 shares</td>
<td>Rs. 1,500</td>
<td>Face value share</td>
<td>Rs. 250</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Bonus shares</th>
<th>Issue at 2 for 3</th>
<th>Market price, etc Rs. 300 per share (cum-bonus)</th>
<th>Face value Rs. 100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of 3 shares</td>
<td>Rs. 900</td>
<td>Value of 2 bonus shares</td>
<td>NIL</td>
</tr>
<tr>
<td>Value of 5 shares</td>
<td>Rs. 1,500</td>
<td>Ex-bonus price, etc Rs. 150 per share</td>
<td></td>
</tr>
</tbody>
</table>

While the above is the arithmetical calculation, it is sometimes found that the above values are not arrived at due to relative strength of the demand and supply position of the particular share. The bye-laws stipulate that all brokers in securities are subject to margin requirements and provisions relating to emergencies. The Gommaing Board has the overall power to regulate trading on the floor so as to ensure a smooth settlement of transactions. Nevertheless, the bye-laws lay down certain guidelines for this purpose.

The provisions in this regard are broadly classified into two parts. The first relates to grid requirements and the second to handling of emergencies.

Shrouded by dispute

Before these provisions are discussed in detail it would be necessary to make some preliminary observations. Because of the speculative activity in stock exchanges in India and elsewhere there has acquired the ill-deserved reputation of being a market without any underlying substance. This is because of the situation of moving at a fast pace. Perhaps, it is in their infancy when company formations were few and far between but money was freely available, there was some justification in support of this view. After a period of years, this view has undergone a change and is now widely accepted that a stock exchange is an institution where investors who have money to invest get expert advice for investment of their surplus and in order to promote the growth of the economy of the country. Nevertheless even with this changed scenario, the vestiges of the old speculation still remain."
INSIDE THE STOCK EXCHANGE - 9
MARGIN REQUIREMENTS

It was stated earlier that all bargains in securities are subject to margin requirements. The word "margin" has not been defined anywhere. It may be explained as the amount which a member is required to deposit with the exchange on the sales or purchases made by him usually calculated at a rate per unit of trading in any security fixed by the Executive Director under the authority vested in him by the Governing Board. The amount so deposited lies with the exchange to his credit and is adjusted against his dues when accounts are settled at the end of the settlement period. As the member is only a broker and not a financier, the bye-laws authorize him to collect the margin amounts from his clients on the transactions which he completes on their behalf.

The purpose of levy of margins is two-fold. Firstly, it ensures safety as part of the purchase price will have to be collected initially, and secondly, while doing so, the exchange ensures that there is some curb on speculative activity.

Presently, there are two types of margins in respect of securities. They are (1) daily margin, and (2) carry-over margin. The operation of these two is precisely described as follows:

Daily Margin: The authority to levy this margin vests with the Board. But as constant vigilance is required on the day to day operations, in Bombay the authority is delegated to the Executive Director. At the beginning of each settlement period, before the trading starts, he notifies the members the rates at which the daily margins will be applicable.

At the end of each business day, the members are required to submit a statement of transactions in the specified security or securities in a form prescribed for the purpose. The statement indicates the aggregate of purchases and sales separately in the specified securities entered into by the member with other members in the market, either on his own behalf or on behalf of his clients (without setting off the purchases of one client against the sales of another's account and vice versa) and also includes (a) its transactions with its constituents as a principal, and (b) transactions put through directly between its constituents. Each day's statement shows the cumulative aggregate of purchases and sales outstanding for settlement at the end of the day.

On the basis of this statement, members are required to deposit the margin amounts as per the prescribed rates in the clearing house giving the details of payment in the form prescribed for the purpose. This is subject to the following modifications:

(a) Members are permitted to adjust the margin amounts against the business done in any security against business done in any other security if the outstanding business in that security has been reduced;
(b) No margin will be required to be paid for purchases in excess of which an approved bank gives the clearing house an irrevocable guarantee that it will take delivery of the security to the due dates.
(c) No margin will be required to be paid in the case of sales if the securities redeemable against such sales are deposited with the clearing house or if an approved bank gives the clearing house an irrevocable guarantee that such securities are in its custody and will be delivered to it on the due dates.

These provisions are considered onerous by the brokers and are resented by them. Though the regulations provide that the clients must furnish the member with the margin payable, they aver that many clients do not do so and they have to bear the burden themselves. This makes the business to gravitate to financially more affluent members who are in a position to accommodate the clients. Secondly, the brokers complain of frequent changes in the rates which tend to make it difficult for them. It must however be pointed out that in the tumultuous years of recent times, the Bombay exchange has not come to major grief only because of the safety value provided by the margin system.

Carry-over Margin: This margin is levied on the sales or purchases carried over from one settlement to another. It was explained earlier that for the purpose of settling the transactions in the stock exchange and determining the liabilities of the members involving the mechanism of 'making-up prices', is adopted. For this purpose on the last business day of the settlement the Executive Director notifies the price for each security on the specified shares list. The same device is also utilized for the purpose of determining the amount of margins payable on the business carried over to the succeeding settlement.

In the case of sales the making-up price is fixed at 3% lower than the normal price and in the case of sales 3% higher. By this device, the purchasing or selling clients are not permitted to take all the profits which have accrued on the margin. The difference is impounded in the account of the broker in the clearing house and the amount so withheld is paid to the client when the contract is finally terminated. There is no discretion to the Executive Director for the fixation of the minimum which is 3% of the price of the security determined as the normal making up price. He is permitted to increase this percentage without any upper limit at his discretion depending on the speculative load in the particular security.

NORMAL PROVISIONS

The following provisions also may be noted:

(1) Failure to pay the margins will result in the suspension of the member for a period of 3 to 5 days.
(2) Margins (daily end carry-over) have to be paid in cash (and not by deposit of securities of equivalent amount).
(3) A constituent is bound to provide the

member with the margin prescribed by the exchange.
(4) On the failure of a constituent to do so, the member is entitled to close out his account and he will be liable to the member for any loss arising to him.
(5) The payment of margin is on the basis of the contract between the member and his constituent. There is no contract between the stock exchange and the client. Therefore, in case of a default in payment by the broker, the exchange is not liable to make good the loss suffered by the constituent.

In addition to these normal provisions, the bye-laws and regulations also empower the Executive Director to direct individuals or deposit ad hoc margins in the clearing house. The amount is fixed at his sole discretion and depends on his subjective assessment of the financial viability of an individual member having regard to the business outstanding in his account. If he is unable to make the necessary margin he would be directed to reduce his commitments to acceptable limits.

While the above provisions should take care of the normal situation, sometimes occasions arise when extraneous circumstances prevail and these tools to contain speculative activity become ineffective. When "boom" conditions prevail, operators in the stock exchange tend to lose their clear sight and levelheadedness. The profits are commensurate with the exceptional profits, but under the anemic umbrella, the resultant situation is described as "conditions are such as to make free trading in securities extremely difficult". To a stranger to the stock exchange, this could appear as a mere understatement of the prevailing situation.

EMERGENCY PROVISIONS

The bye-law relating to a "comer" stipulates that it is a situation where a single interest or group has acquired such control of any securities or group that the same cannot be obtained for delivery on existing contracts except at prices or on terms arbitrarily dictated by such interest or group. In such a case, the Governing Board may prohibit further dealings in such security or securities while allowing dealing in delivery or liquidation of existing contracts. This is a means of safeguarding a speculative position in any security or group. It is an attempt at a balanced approach to the problem of speculative glut.

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equilibrium between the sellers and the buyers so that normal trading is possible.

Sometimes when the occasion arises jobbing is also forbidden on the ground that this mechanism is used by speculative elements to increase their position. But there are two views on the provision. Some circles observe that jobbing alone can help in reducing the load and in a rising market it will have no effect on accelerating the price line and therefore should be permitted. But others claim that it is not possible to over-see the misuse by speculative elements particularly when the three functions, jobbing, broking and trading are not separate but are interrelated intermingled. If, in spite of these restrictions, there is no appreciable reduction in the load, it means that the floating stock in the particular scrip has dwindled and therefore it does not qualify for con-

The converse of a corner is the crisis. This is a situation where there is a panic on account of external events such as war or there is a bear raid by interested parties to unduly depress the price of a security and a fair or normal market does not exist. It may be remembered that such a situation arose in 1969 during the Chinese incursions and in 1984 in the wake of the assassination of Mrs. Gandhi. In such situations, the bye-law advocates the following steps—

(i) Prohibition of short-selling and/or
(ii) Prohibition of minimum prices below which sale or purchase cannot be made; and/or
(iii) Closure of the market in whole or in part; and/or
(iv) prohibition of further dealings while allowing dealings for closing-out of existing contracts.

Sales and purchases for delivery are permitted. In such a situation, prohibition of jobbing becomes necessary. This is to avoid jobbers purchasing in the beginning of the session in large bulk and then selling them later and thus depressing the market further. During the period of emergency, selling-out is suspended. This means that sellers on existing contracts cannot enforce delivery.

UNLESS otherwise instructed, the stock exchange is empowered to withdraw the admission to dealings in the shares of the company in which the party in default acquired its shareholding unless it succeeds to less than 10% of the voting capital of the company.

There are many procedural provisions which are not relevant here. But two stipula-

But the losses, if any, be borne by the

TAKE-OVER BIDS

These take-overs have become very common in India. Often the group wanting to take over the control of a company comes on the negotiations with the management privately and quite often the negotiations are far divorced from the ruling market price of the

In London, there is an informal take over code for which the stock exchange subscribes and which is administered rigorously. Most of the take-overs in UK appear to be a big company taking over a smaller company and not in the manner in India where merg-

The operative part of the clause lays down that an individual or a group or a body corporate shall not jointly or severally, either in his own name or in the name of any other person—

(i) Acquire any shares in a listed company, if the total nominal value of the shares intended to be acquired exceed, together with the shares already held, in the aggregate 25% of the voting capital of the company; or

(ii) Secure effective control of the management of a company by acquiring, irrespective of the percentage of the voting capital, the shares of the directors and their associates who by virtue of such holdings effectively control the company.

Unless an offer is made to the remaining members of the company to acquire their shares at a price not lower than the price at which the shares of the majority group are being acquired, the offer has to be on such terms and conditions as the share exchange prescribes but the clause as limited by the proviso that the offer to the remaining shareholders shall not under any circumstances result in the public shareholding being reduced to less than 20% of the voting capital of the company.

INSIDER TRADING

This term by definition means trading in the shares of a company by the management or circles close to it. It also includes trading by persons who are privy to the special information relating to a company in whose shares they have invested and profited on the basis of the information which has come into their possession. As is very well known, this practice is very widely prevalent in India and of late it is spreading. Beyond making profit from short-term pronouncements, authoritative circles have done precious little about its eradication. In U.S. however there is a law which makes such trading a criminal offence and further stipulates that profits earned in such deals be added to the funds of the company for the benefit of the shareholders.
THE CLEARING HOUSE

It was clarified earlier that in the Bombay Stock Exchange (BSE), the settlement of contracts is done through the clearing house (CH), fully in the case of specified securities and partly in the non-specified. In other words, while the CH effects delivery of shares and settles the money claims of the brokers in specified shares, it confines itself to the money claims only in non-specified shares, while the delivery of the shares is effected from office to office by the members. The exchange has a statutory duty to see that the transactions in the ring are settled periodically and smoothly.

In regard to the volume of transactions in Bombay, the exchange, as far back as 1920, appointed the Bank of India to run the CH on its behalf as its agent and the arrangement still continues. In other exchanges, a more or less similar arrangement is made, modified to local conditions.

Role of clearing house
It is necessary to appreciate the proper role of the CH in stock exchange operations. By only a machinery to aid the members in the settlement of their transactions inter se (which would otherwise have been their individual responsibility), the CH cannot obviously guarantee the title, ownership, or genuineness of any security or any other document passing through its hands. Its only obligation is to facilitate the delivery and payment in respect of securities, transfer deeds and any other documents between the members. As a corollary to this proposition, no liability in this regard shall attach either to the exchange or the Govt. depository (GD) or any member of the GB. Consequently, the byelaws also protect a member for any delay on the part of the CH in the course of its operations.

However, all sums of money paid into the CH and all credits appearing in its books on account of any member entitled thereto are declared to be held by the GB on behalf of the exchange as agents of the members and in trust for such members. No other members shall be entitled to levy any attachment or execute on therein and neither the exchange nor any member thereof nor any other person shall, subject to any law for the time being in force, be deemed to have any right, title or interest in any such money or credit.

However, the GB has a right to borrow money against and pledge for the payment therefor all or any part of the securities held by the CH for the account of any member who fails to take up and pay for such securities on the pay-in day.

The situation gets altered when a member is declared a defaulter. In such an event, the clients' interests are protected. It is stipulated that neither the exchange nor the creditors of the defaulter shall be entitled to any lien on the securities delivered by him to the CH on behalf of his clients. On the clients offering satisfactory proof, they have to be returned subject to payment, if any due, to the defaulter.

In the course of its operations, the CH is authorised at its discretion to deliver to the receiving member either the same securities tendered by the corresponding selling member or securities of a like kind. In other words, where member A has sold 100 shares of TISCO to member B and delivers to the CH 100 shares with some distinctive numbers, the CH may deliver to member B either the same shares with the same distinctive numbers or 100 other TISCO shares having the same rights. Such a stipulation is necessary as in the course of a fortnight's trading, there would be thousands of contracts for purchase and sale and in the process of settlement, the intermediaries are eliminated and the first seller and the final buyer are brought face to face. Therefore, the byelaw stipulates that members giving and receiving delivery shall be deemed, notwithstanding that no direct contract exists between them, to have made a contract with each other as sellers and buyers.

However, the rights and liabilities of such members in relation to their immediate contracting parties are not affected thereby. But this stipulation does not operate when delivery is effected outside the CH. The deliveror alone is responsible to the receiver.

Only members are entitled to clear and settle contracts through the CH. They are also permitted to act through their bankers in which case their names have to be approved by the exchange and they must agree to abide by the byelaws and regulations.

There are certain provisions in the byelaws which are no longer followed in practice. These relate to the help the CH is required to render in specifically designated securities to the members to procure sub-divided certificates, provisional documents or split records or cancelled transfer deeds. The CH in Bombay does not render such services on account of the fact that even otherwise it is overloaded with the current work.

Accounting of interest/dividend/rights

There are special eyewalls which lay down under what circumstances a buyer or a seller of securities is entitled to the benefits accruing to their ownership. It is necessary to have these provisions in order to avoid disputes between the trading parties. As a rule, it is laid down that the buyer is entitled to receive all vouchers, coupons, dividends, cash bonus, bonus issues, rights and other privileges which may appertain to securities bought cum-voucher, cum-coupon, cum-dividend, cum-cash bonus, cum-bonus, cum-rights etc. In other cases where the trading is done on ex-rights basis, it is the seller who is entitled to receive the same.

There is, however, an exception to this general rule in the case of government securities. As the return in these securities is fixed and the dates of payment of interestPath also in the case of non-specified shares was clarified. It may be added that if there is a delay in the information regarding these happenings reaching the exchange, the relevant dates are shifted to the period following the receipt of such information. Till such time, the transactions continue on an ex-rights basis.

In one of the earlier articles, the date of marking transactions ex-dividend, ex-bonus etc. both in the specified and non-specified shares was clarified. It may be added that if there is a delay in the information regarding these happenings reaching the exchange, the relevant dates are shifted to the period following the receipt of such information. Till such time, the transactions continue on an ex-rights basis.

It was also stated earlier that in the case of cum-transactions, the buyer is entitled to the benefits accruing to the shares purchased by him. At times the seller does not deliver the documents in time for the buyer to lodge them in the company. As a result, the seller will continue to get the benefits as his name would continue in the company's Regis-
ter of Members and it will send the documents to him only. In such an event, the byelaws permit the buyer to deduct from the purchase price the dividend declared or recommended and to which he is entitled. In the case of a bonus before or after rights, the buyer may deduct from the purchase price an amount equivalent to the proportionate value of the bonus issue or rights to which he is entitled. The amount so retained shall be paid to the seller when he delivers the bonus issue or rights. If the seller fails to do so within the prescribed time, the buyer is entitled to buy-in against him.

V.D. Sonde
Mr. Sonde is the former Executive Director, in an authority to the BSE. Was engaged in the Clearing House of the Stock Exchange Manager and retired as Commissioner of Income Tax, Bombay.
INSIDE THE STOCK EXCHANGE

TRANSFER OF SHARES

The byelaws lay down that delivery of all documents and papers and the payment in respect of all contracts shall be within the Fort area of the city of Bombay and the parties are bound to give and take delivery in Bombay only. It is also stipulated that the documents when tendered should satisfy the conditions of 'good delivery' laid down by the Governing Board from time to time. The current issues in this regard were explained in one of the articles in an earlier issue of this magazine.

Another requirement is that the delivery is to be effected in prescribed lots. This requires some clarification. Assume that the market or trading lot in a security is 100 shares. The delivery member has 4 share certificates of 25 each, where the transferring client is the same. In this case, delivery can be effected by one transfer deed signed by the constituent by attaching the 4 certificates. Let's suppose that 2 of the share certificates are in the name of another client. It would still be possible to affect the delivery by having the second transfer deed signed by the other transferring client. It is not permissible to make up the lot of 100 shares belonging to more than two shareholders necessitating the use of three or more transfer deeds. In other words, the prescribed lot can be made up of any number of share certificates, the accompanying transfer deeds must be restricted to 2.

It is obligatory on the part of the buyer to accept the documents tendered in performance of the contract, if they are regular, genuine and valid. If they are not valid, he is entitled to refuse delivery. But if he does so for no adequate reason, the seller is entitled to sell out the same against the buyer.

Sometimes disputes arise regarding the defective nature of the documents tendered for delivery. The matter is then referred to the members of the Arbitration Committee for an on-the-spot decision and the decision given by them is followed.

The byelaws stipulate that a sale of securities is not conditional on the company transferring the securities to the name of the buyer. On the sale of securities, the only obligation on the seller is to tender documents that are not defective and he shall not be deemed to guarantee that the company will transfer the securities to the name of the buyer nor shall he incur any liability by reason of the refusal of the company to do so.

Disputes are considered only if there is a defect in their title, ownership, genuineness, regularity or validity or if they are under any lien or account of any debt or liability of the transferor or if they are subject to any attachment or injunction or other legal proceedings or order of court or any other statutory authority for which the seller may be held responsible.

But once a transfer has been accepted by the company, neither the buying member nor the selling member shall be personally responsible for the buying constituent or the transfereree for any subsequent dispute as to the title, ownership, genuineness, regularity and validity of the documents unless bad faith or fraud be proved against such a member. However, the buying and selling members are bound to render every assistance to the buying constituents in any action at law or other proceedings they may take against the selling constituents.

Provisions of transfer

At this stage, it is necessary to discuss the provisions relating to the transfer of title in securities. While the primary provisions are contained in the Companies Act, the byelaws stipulate the procedure that has to be followed when the transfer of documents are refused by companies under objection.

Sec 82 of the Companies Act stipulates that the shares or other interest of any members in a company shall be moveable property, transferable in the manner provided in the articles of the company. Therefore, the articles must provide the manner in which the transfers are to be effected. Where no such provision exists, the regulations in Table A of Schedule I apply.

However, the articles cannot prohibit in toto the right of transfer as such right is given by the statute. They can put reasonable restrictions. For example, the regulations authorise the Board of Directors to decline to register the transfer of a share, not being a fully paid share, to a person with whom they do not approve or any transfer of shares on which the company has a lien. Many companies provide in the articles an authority to the Board to refuse transfer to the names of persons whom they do not approve. However, all these powers are subject to an appeal to the Company Law Board (CLB).

Under Sec 108 (1) of the Act, a company will not register a transfer of shares, or debentures of the company unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee, has been delivered to the company along with the certificate relating to the shares or debentures, or if no such certificate is in existence along with the letter of allotment.

While this sub-section did not prescribe any form for the instrument of transfer, the Act was amended with effect from 1-4-1966 by the insertion of a new sub-section (1A) by which the following requirements were laid down:

(1) Every instrument of transfer shall be in the prescribed form; this was done by way of Form No. 7-A in Appendix I to the Companies Act.

(2) Every such instrument, before any entry is made therein, be presented to the prescribed authority who shall stamp or otherwise endorse thereon the date on which it is so presented. At present, the prescribed authorities include Registrars of companies and in some places, income tax officers.

(3) The instrument of transfer after it is executed by or on behalf of the transferor and the transferee and completed in all respects should be delivered to the company:

(a) In the case of listed shares any time before the date on which the Register of Members is closed for the first time after the date of presentation or within two months of the date, whichever is later;

(b) In any other case within two months from the date of such presentation.

Problems in transfer

Having spelt out the basic requirements of the law for transfer of title in shares from one hand to another, it is advantageous to understand the legal position in respect of problems which frequently arise. These relate to:

(a) Loss of share, or debenture certificates

(b) Blank transfers

(c) Death of transferor or transferee before registration by the company

(d) Transfer by a representative

(e) Forged transfers

These are discussed below:

(a) Loss of share or debenture certificates: It is an essential condition for the transfer of shares or debentures in sub-section (1) of Sec. 108 of the Companies Act that the instrument of transfer must be accompanied by the certificates. Therefore, if the certificates are lost or misplaced, it will be necessary to obtain duplicates.

(b) Blank transfers: In the case of a blank transfer, the seller only fills in his name and signature. Neither the buyer's name and signature nor the date of sale is filled in the transfer form. The advantage in giving such a blank deed is that the buyer is again at liberty to sell to a subsequent buyer. The process of purchase and sale can be repeated any number of times till the documents reach the person who wants to retain the shares. He then fills in his name and date and gets the deed registered in the company's books.

Sub-Sections (1-A to 1-D) were introduced in the Act to regulate and control the currency of blank transfer of shares. This is sought to be done by limiting the currency in the manner indicated
above. The not result of this provision is that blank transfers are valid in a stock exchange till the closure of the Register of Members. From the time the blank transfer deed is dated by the prescribed authority till the date of the closure of the register, blank transfer deeds pass from hand to hand in the exchange. A record of such transfers is however kept at the back of the deed where the delivering member has to note his name and the date before handing over the same to another. Such a record is valuable to determine the liability of intermediary parties in case of any objection raised by the company to whom the documents ultimately reach.

The following points are also worth noting in this regard. They are relevant to trading in Bombay.

(i) Transfer deeds are printed by the exchange. They are authenticated by the prescribed authority and then distributed to the members through the clearing house after levying a nominal charge.

(ii) There is no obligation for a company to close its Register of Members even for a day. However, as a matter of routine, the register is closed at the time of the AGM when the company wants to ascertain the shareholders who are entitled to dividends or when right or bonus shares are listed. Therefore, when debentures are issued the common practice is to fix a record date. By this practice, the companies see that the transfer deeds continue to be valid as the register is not closed.

(iii) Under Sec. 108 (1-A), a transfer deed is valid till the closure of the Register of Members for the first time after the date of authentication or two months from that date, whichever is later. Notwithstanding this statutory provision in the BSE, all deeds authenticated before the date of closure of books cease to be good delivery after that date. The justification for this practice is that such a deed has a limited currency as against the longer currency available to deeds introduced after that date and this is liable to create confusion in trading.

(c) Death of transferor or transferee before registration: When the transferor dies but the company does not receive any intimation of his death, it will normally register the transfer. But if the company has such intimation, the prudent course for it would be to refer to the legal representative. The same may or may not be the case in the event of the death of the transferee. The important factor is whether or not, at the time of giving effect to the transfer, the company was aware of the death.

(d) Transfer by a representative: When the transfer is executed by a person in a representative capacity, the authority under which the transfer is so executed must be produced before the company. Under the BSE rules, the power of attorney is required to be registered with the company and the relevant information must be given at the back of the transfer deed.

(e) Forged transfers: A forged transfer is ipso facto void and cannot pass valid title. It is no defense if the transferee claims that he had no knowledge that the signature was forged. The only defense perhaps would be to show negligence on the part of the transferee. This may prevent him from prosecuting his case further.

Unregistered transfer rights
Sometimes questions are raised as to what are the respective rights of the transferor and the transferee where the shares are transferred under a regular instrument or a blank transfer form, but the transfer is not registered either because the company has refused to register or the transfer deed has not yet been delivered to it. It may be noted that the latter contingency frequently arises in stock exchange dealings, as blank transfers in the manner described earlier are usually in circulation in the market till the date of the next book closure.

The following excerpt in Vaipaiapal Sayi vs. Venkata Punnaya (1955) 1 Comp. L.F. 257 makes the position clear:

"In Howrah Traders Co. vs. Commissioner of Income Tax, Central, Calcutta, ASR 1959 SC 775, the Supreme Court has held that the transferee of shares transferred by way of blank transfer has not the benefit of a legal title until his name is entered in the register of members, although upon completion of the transaction by having the name entered in the Register of Members relates it back to the time when the transfer is made. During the period the transfer exists between the transferor and the transferee without emerging as a binding document upon the company, equities exist between them, but not between the transferor and the company. The transferee can call on the transferee to attend the meeting, vote according to his directions, sign documents in relation to the issuance of fresh capital, call for emergency meetings, and inter alia also compel the transferee to pay such dividend as he may have received."

In other words, during this period, the transferor should act as a trustee for the transferee and should duly account to the latter for all the benefits which accrue to him, such as rights, bonus or dividend, solely because of his legal ownership of the shares.

Stamp duty
Under the law, the instrument of transfer must have been stamped with proper stamp when it is delivered to the company. There is no obligation on the part of the company to receive the instrument of transfer without the requisite stamp fixed on it, even when it is accompanied by sufficient money to cover the stamp duty and with a request that the stamping may be done by the company. But there is no legal objection, if the company chooses to do so by way of doing agency service to the applicant.

It is therefore absolutely necessary that all the legal requirements regarding the transfer are complied with before the instrument is presented to the company. The matter assumes importance as a transfer deed becomes time-barred by the date of the book closure when perhaps the applicant is unable to re-present it to the company before the books close. As the transfer is not given effect to in time, all the benefits will accrue to the transferee whose name will still be registered with the company as a shareholder.

Stock exchanges have been requesting the government to introduce a provision in the Act making the company hold such accruing rights as dividend, bonus etc., in a separate account and then remit the same to the transferee after all the formalities are complied with and the transfer is complete. But this remedy is available only in a case where the instrument of transfer is presented to the company making it aware of the intended transfer and not otherwise.

Joint shareholders
In the case of shares held jointly by more than one person, the company is not concerned about their inter se. They can insist on having their names registered in such order as they may require. But if they want to split their shares and register it in their individual names, they must follow the procedure for transfer of shares. This will also be necessary if another name is to be added.

But in the case of death of a joint shareholder, the situation will depend on the Articles of Association of the company. Regulation 29 of Table A of Schedule I of the Act permits a company to adopt an article to the effect that:

"On the death of a member, the survivor or survivors where the member was a joint holder, and his legal representative, where he was not, shall be the only persons recognised by the company having any title to his interest in the shares." In the absence of such a rule, the person, or persons entitled as heirs of the deceased joint shareholder will be registered as members jointly with the surviving joint shareholders.

In the case of joint shareholders, notices and the other documents will be sent to the first named of the joint shareholders as entered in the Register of Members, and similar is the case with payment of dividend.

The other points to note in this connection are:

(a) The joint holders are jointly and severally liable to pay all calls in respect of the shares; and

(b) In the case of transfer of shares jointly held, the transfer will be effective only if it is made by all the joint holders.

Power to refuse transfer registration
A company can take power under its articles to refuse to register the transfer.
But where it so refuses, Sec. 111 of the Act requires that it should send notice of the refusal within two months from the date on which the instrument was received by it. Failure to do so entails the levy of fine on the company and its concerned officers. The Section also provides for an appeal to the Central government within two months of the receipt of refusal.

Normally companies arm themselves under the articles giving the Board of Directors absolute and uncontrolled discretion, without assigning any reason, to decline to register any transfer of shares. It has been held that the adoption of such an article does not mean that there is a restriction on the free transfer of shares as in the case of a private company. The object in such cases is to arm the directors with power to be exercised in special and exceptional cases where the transfer may be found to be undesirable in the interests of the company.

The following observations of the Supreme Court in the case of Bajaj Auto Ltd. Vs. N.K. Pirudia (1971) 41 Com. Cases 1 are relevant:

"Even where the articles confer on the directors absolute and uncontrolled discretion to decline to register any transfer of shares, the power should be exercised bona fide and not arbitrarily or for any collateral motives. Discretion does not mean a bare affirmation or negation of a proposal. Discretion implies just and proper consideration of the proposal in the facts and circumstances of the case. In the exercise of discretion the directors will act for the permanent interests of the company and for the general interest of the shareholders because the directors are in fiduciary position both towards the company and towards each shareholder."

Sec. 113 of the Act requires that every company shall, within two months after the application for the registration of transfer of any shares, complete and have ready for delivery the certificate. In case of default, the affected party may apply to the court for an order directing the company to issue the certificate in respect of which the default has been committed. But before doing so, he must first serve a notice on the company and only in the event of it failing to comply with the notice within ten days, application to the court will lie. The "Companies (Issue of Share Certificates) Rules provide that no duplicate share certificate shall be issued in lieu of those that are lost or destroyed without the prior consent of the Board of Directors to any payment of such fees. It may exceed Rs. 2 and on such reasonable terms, if any, as to evidence and indemnify and the payment of out-of-pocket expenses incurred by the company in investigating evidence, as the Board thinks fit.

It may also be noted that under Sec. 155, the court has powers to rectify the Register of Members if: (a) The name of any person — (i) is, without sufficient cause, entered in the Register of Members, or (ii) after having been entered in the register is, without sufficient cause, omitted therefrom; or (b) Default is made or unnecessary delay takes place in entering in the register the fact of any person having become, or ceased to be, a member.

V.D. Sonde

Mr. Sonde, a former Executive Director, is an Advisor to BSE. Was earlier in charge of the Stock Exchange Division of the Finance Ministry and retired as Commissioner of Income-tax, Bombay.
It was discussed earlier that provisions of Sec 108 (1-A to 1-D) were introduced in the Companies Act in 1966 to regulate and control the currency of blank transfer of shares. An attempt on the same lines was made earlier under Sec. 27 of the Securities Contracts (Regulation) Act (SC (R) Act) of 1956. This was done by stating that: “It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred to him for consideration, unless the transferee who claims the dividend from the transferee has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due”.

Ensuring transferability

Recently, another amendment to the Act was carried out to ensure free transferability and registration of transfers of listed securities of companies. It will have been noticed from the discussions earlier that under the Act while there is a time limit of two months for both the refusal and acceptance of the transfer request, the company is required to notify to the applicant only the refusal and in the case of acceptance, the documents have to be completed and kept ready for delivery.

Therefore, provision has now been made in the SC (R) Act by the introduction of Sec. 22 A to ensure free transferability and registration of transfers by listed companies. Under this Section, a company is empowered to refuse registration only on one or more of the following grounds and on no other ground, namely:

(a) that the instrument of transfer is not proper or does not comply with the requirements under the law relating to registration of such transfer;
(b) that the transfer is in contravention of any law; or
(c) that the transfer is likely to result in such change in the composition of the Board of Directors as would be prejudicial to the interests of the company or to public interest;
(d) that the transfer is prohibited by any court.

The Section also lays down that the company must effect registration within two months if it is satisfied that it should not be refused. Where the instrument is defective, it should notify the transferee and the transferee about the defects and get them removed. In any other case, it must make a reference to the Company Law Board (CLB) and forward copies of such reference to both the transferor and the transferee.

Note that here also there is no provision that the transferor should be notified that the request has been accepted within two months. However, the parties concerned may assume that the transfer has been accepted if copies of reference to the CLB are not received within the stipulated time. The Section ensures the observance of the time limits by the provision that in case of default, the company and every officer who is in default shall be punishable with fine extending to Rs 100. The correctness of the reference is ensured by a punishment, in case of default, with imprisonment which may extend to three years in addition to fine.

However, the effect of these provisions has not been felt much in stock exchange circles. Brokers still complain of delays in receipt of shares lodged for transfer.

Byelaws of stock exchanges

In the earlier part of this article it was clarified that documents are considered defective if there is a defect in their title, ownership, genuineness or if they are under any lien on account of any debt or liability of the transferee or if they are subject to any attachment or injunction or other legal proceedings or order of court or other statutory authority for which the seller may be held responsible.

The first requirement in such cases is to fix responsibility. During the period of currency of a transfer deed, the documents may pass from hand to hand and disputes often arise regarding the identification of the member responsible for the introduction of the defective documents in the market. Mostly, the documents are returned by the company on the ground that “the signature differs”.

In such cases, identification is easy as the transfer deed will bear the stamp of the member who has first introduced them in the market. It is his responsibility to replace them with valid documents. But difficulties arise when after the documents are in circulation for some time, a court order or attachment or injunction is received and the company is prevented from giving effect to the transfer. In such cases, the matter comes up before the Arbitration Committee for adjudication.

There is only one limitation for the buyer to locate the objection and claim from the seller. He has to do so before the transfer books of the company close for the first time after the documents are in his hand. Also, note that if the original seller fails to meet his obligations, the responsibility shifts to the subsequent selling member. In case of circumstances not covered by the byelaws, the Governing Board (GB) determines the liability of the parties on equitable considerations.

If the above condition is not satisfied, the original and subsequent selling members are absolved of their responsibility except in the case of fraud or bad faith.

The above responsibility is fixed under the byelaws without in any way jeopardising the rights and liabilities of the buying or selling clients. They make it clear that if the buying client takes any legal proceedings against the person who has received payment against receipt of the defective documents all the concerned members must render every assistance to him in the prosecution of this case. As a result, the selling client is also bound to make good any damages sustained by the selling member on his behalf.

Once the selling member responsible for the introduction of the defective documents is identified, he has fifteen days' time to remove the defect or in the alternative to replace them with valid documents. This time can be enlarged by the GB in the following situations:

(a) when the documents are alleged to be forged or stolen, till the time the allegation is established either to the satisfaction of the Board or in the court of law;
(b) when an attachment or injunction is served on the company, till the time the final decision in the matter is obtained;
(c) in any other case, the company is obligated not to transfer, till the time the obligation is removed.

Protecting buyers

The byelaws also make provisions to protect the interests of the buyer in case the selling member fails to remove the defect within the period of fifteen days. It is stipulated that in such a case he will be entitled to claim from the selling member refund of their value at the then ruling market price. At the same time while claiming the refund, the buyer has to return to the selling member the defective documents (if they have not been impounded) and must also procure for the selling member at the latter's expense, an irrevocable power of attorney executed by the owner in favour (selling member) or his nominee to institute proceedings on behalf of the transferee and to litigate the dispute to have the objections cleared against the documents cleared. In other words, it is the duty of the buying member to fully cooperate with the selling member for getting the objections removed.

The above requirement is necessary because the refund of monies relating to the defective documents does not operate...
the cancellation of the contract. The reason is that the byelaws respect the inviolability of the contracts and no contract can be cancelled except under a specific allegation of fraud or wilful misrepresentation. In addition, the GB may also consider fit for adjudication a case when prior facie evidence it comes to the conclusion that a material mistake is made in the bargain which calls for its interference.

Therefore, if within thirty days of the payment of the refund or within such further time as the GB or the President may allow from time to time, the seller removes the defect or in the alternative replaces the defective documents with valid ones, the buyer is bound to accept the same in fulfillment of the original contract and return to the selling member the monies refunded to him. However, if during the period taken by the selling member to remove the defect or replace the documents, the company declares any dividend, bonus, or rights etc., he will be accountable to the buyer for them.

V.D. Sonde

Mr. Sonde, a former Executive Director, is an Advisor to SE. Was earlier in charge of the Stock Exchange Division of the Finance Ministry and retired as Commissioner of Income-tax, Bombay.
RIGHTS & LIABILITIES

A point was made in the beginning of this series of articles that the organisational pattern of the stock exchanges in India, as indeed elsewhere in the world, was designed in the interests of the members and the rules, byelaws and regulations were so framed as to subserve the interest of the members who together constituted the organisation. In 1956 when the exchanges were recognised under the Securities Contracts (Regulation) Act, this pattern was continued and largely the government abstained from interfering in their internal affairs. That the byelaws were framed more in the interests of the members themselves with the constitution being a hindrance is more evident than the two Chapters in the byelaws which are headed ‘Dealings by members’ and ‘Rights and liabilities of members and constituents’. In both these Chapters, by and large, the rules mention the rights of the members vis-à-vis their constituents (clients) rather than their liabilities towards the latter.

Let us now have a look at the rights of a member and also his liabilities towards his client.

Rights of a member

1. The exchange does not recognise as parties to any bargain in the market any persons other than its own members.
2. A member is permitted to employ another member as an intermediary to put through the transaction of a non-member. The only condition is that the price reported to the non-member must be the same at which the transaction is put through by the intermediary.
3. A member is permitted to match a selling order of one client with a buying order of another.
4. When executing an order, a member may buy or sell securities on his own account as a principal provided: (a) the price is fair and justified by the condition of the market; and (b) the consent or authority of the constituent has been obtained.
5. When a member has been given instructions by another member or by a non-member to receive or give delivery of securities from or to another member or non-member and all the parties agree so to give or take delivery (as the case may be), a member may enter into havala contracts in accordance with such instructions.
6. When a constituent is indebted to a member, all securities and other assets including cash lying to the credit of the constituent may be held back as a general security for payment to such member of all monies (including interest, commission, brokerage and other expenses) as may be due by the constituent.
7. The member has a right to sell the securities in case of failure to pay his dues on the part of the constituent and appropriate the proceeds.
8. Every member is deemed to be indemnified by the constituent as an agent acting on behalf of the principal when he executes a contract on behalf of the latter.
9. A member is not bound to accept all or any of the instructions or orders of the constituents. He may decline to do so without assigning any reasons whatsoever. The only limitation is that he must immediately inform the constituent to that effect.
10. A member has a right to demand from his constituent the margin deposit he has to provide under the Rules. He also has the right to demand an initial margin in cash and/or securities before entertaining a client’s business.
11. A member has a right to refuse to transact business for a client who, to his knowledge, is in default to another member.
12. If, through lack of knowledge or otherwise, a member entertains the business of a client who is in default to another member, the latter has a right to bring the same to the notice of the exchange. The exchange will then direct the member to deposit the monies or securities belonging to the defaulting client with the Clearing House. The money will be released only after the dispute between the defaulting client and the complaining member is settled.
13. A constituent (whether residing in Bombay or outside) must deliver the securities sold by him with valid documents in the office of the member in the Fort area of Bombay.
14. Similarly the constituent must make the payment for the securities purchased by him in the broker’s office in Fort area of Bombay at least one day previous to the pay-in day.
15. If the constituent fails to meet the above obligations, he shall be answerable to the member for any loss or damages which he may sustain as a result of such failure.
16. If the constituent fails to pay the damages, the member has a right to close his account and give to the former due notice to that effect.
17. On the death of the constituent or his being declared bankrupt, the member has a right to close out all open transactions. He may do so either by taking over the transactions in his own account as a principal at prices which are fair and justified by the condition of the market or he may close out in the market at the cost of the constituent.
18. A member is under no obligation to attend to the transfer of securities and the registration thereof in the name of the constituent. He attends to such work only as an agent and all the charges payable to the company have to be borne by the constituent.
19. When the time available is not sufficient to complete transfers and lodge the securities for registration before the closing of the transfer books, a member may register the same in his or his nominee’s name. He has to intimate to the constituent accordingly.

Rights of a constituent

1. If a member fails to complete the performance of a contract, the constituent has a right to close out such contract through any other member of the exchange within fifteen days from the date of the default after giving due notice to the defaulting member. If the closing out is not effected within fifteen days, the damages shall be determined on the basis of the closing prices ruling on the fifteenth day.
2. A constituent has also the right to close out all outstanding contracts with a member if the member: (a) is declared a default; (b) fails to pay damages sustained in the closing out of the contract effected earlier; (c) fails to pay differences due to him on the day following the pay-out day.
3. If a member is declared a defaulter after delivering securities to the Clearing House on account of his constituent, the latter is entitled to claim, on providing sufficient proof, either such securities or the value thereof subject to payment or deduction of the amount if any due by him to the defaulter.
4. Finally, when a client complains that a member has failed to implement his stock broking business the Governing Board may suspend him or take such disciplinary action as it may deem fit.

Brokerage

The question brokerage assumes importance in stock exchange trading as primarily a member of the stock exchange is a broker who purchases or sells securities on behalf of his clients. Brokerage is permitted to be charged on the following transactions:
1. Purchase or sale of securities.
2. Carry over of securities. Though the same transaction of purchase or sale is carried over from one settlement to another, separate charge of brokerage is permitted as the old transaction is technically terminated by a cross transaction and a fresh transaction for the ensuing settlement is entered into at the making up price along with the balance charges, if any. However, if there is a compulsory carry over ordered by the stock exchange, the brokerage chargeable is at rates not exceeding one-eighth of the offi
cial scale.

3. Purchase of securities on which calls have been prepaid by the seller — brokerage is charged on the purchase price with the amount of calls added.

4. Brokerage is shared with another member through whom the transaction is put through.

5. On transactions carried through directly between two clients.

6. On arbitrage transactions.

7. On new issues and offers for sale.

There is a specific bylaw which lays down that no allowance, rebate, return or division of brokerage or commission of any nature or character shall be made by any member to any constituent. It is also stipulated that a member shall not act as a principal or enter into any agreement or arrangement with a non-member whereby special or unusual rates are given with intent to give special or unusual advantage to such non-member for the purpose of securing his custom or business.

Lest a member may feel that under the byelaws he is obliged to charge brokerage in cases of charity also, it is provided that in such cases he may relinquish his brokerage.

Notwithstanding the provision which disallows allowance or rebate or division of brokerage, it is widely known that, in recent times, such inducements are given particularly in the case of new issues. Justification for this practice is derived from the byelaw which mentions the entities with whom the brokerage can be shared with. It is provided that a broker can share brokerage with the following:

1. His remisier, authorised clerk or employee in his own exclusive employment;

2. With any other person introducing a constituent provided such person: (i) is not one for or with whom members are forbidden to do business; (ii) is not the remisier, authorised clerk or employee in the employment of another member; (iii) does not advertise in the press or in any other manner that he is acting as a broker; (iv) does not act as a broker within a distance of fifty miles of the city of Bombay; (v) does not pass contracts in his own name or issues price lists or pamphlets or circulars in respect of business in securities if working within a distance of fifty miles; (vi) does not issue price lists, pamphlets or circulars to other than his own clients if acting as a broker beyond the distance of fifty miles.

It will be noticed that the wordings of this byelaw are so wide that sharing of brokerage with a client can easily be accommodated. But even so, the same byelaw continues to assert that the shares in the brokerage must not give any rebate or allowance to the constituent.

Sharing of brokerage is permitted up to 50% in the case of the remisier or authorised clerk and up to 40% in other cases.

The members' interests are protected. In the absence of an agreement to the contrary, the shares in the brokerage is deemed to indemnify the member for any loss which he might sustain on the transactions entered through them. In case of a default by the constituent, the loss becomes immediately payable to the member by the shares in the brokerage.

He is also empowered to proceed for recovery against the constituent at the risk and cost of the introducing party. Disputes between the member and the shares in the brokerage are to be referred to arbitration, and decided in accordance with the byelaws.

V.D. Sonde
**Contract notes**

**V.D. Sonde**

The byelaws do not lay down that members of stock exchanges **must** issue contracts for the transactions done by them on behalf of their clients. All that they do is to prescribe forms of contract notes: (1) by members as agents — Form A, (2) by members as principals — Form B, and (3) carry over contracts.

There is no material difference between the two forms A and B except that Form B bears the superscription: "Contract note issued by members dealing with constituents as principals." The same forms are to be used for the carry over contracts. The brokerage charged is not separately shown in Form A but it carries the following legend: "Brokerage has been charged at rates not exceeding the official scale of brokerage and is included in the price."

**Stamp duty**

Some years back an eminent legal authority took the view that stamp duty is not payable on transactions but only when a contract recording the transaction is issued to the client. On the strength of his legal opinion, brokers with a view to escape stamp duty started issuing bills to their clients, showing the details of the transactions carried on their behalf and the amounts due to or by them. The view was not accepted by the Stamp Office who held that members are obliged to pay duty on the transactions whether the contract notes confirming the same are issued or not. The practice has now developed, so as to avoid the issue of a contract note in each and every case, for a broker to get his transactions adjudicated by the Stamp Office for specified periods and to pay into the treasury consolidated duty.

While this may solve the problem of payment of stamp duty for the broker, it is in the interest of the client to get a regular contract note. Courts have held that the arbitration machinery swings into operation only when a contract note is issued and not otherwise. The stock exchange arbitration machinery (to be discussed later) is a much quicker remedy than the normal resort to a civil court. Therefore, a client is well advised to insist that his broker issues the contract note.

Readers have asked to be enlightened on the difference between a bill and contract note. It has been explained that a contract note is a legal document while a bill is not. Moreover, the contract note only mentions the number of securities, the kind and the rate, while the bill gives the amount due or payable by the client along with the transfer charges. Brokerage is not separately shown in either as it is included in the rate. Presently brokerage charged is stated to be within the range of 0.5% to 2.5%. A client is entitled to get the relevant information from his broker.

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**TABLE 1**

<table>
<thead>
<tr>
<th>Securities of the government of India and State government of face value</th>
<th>Brokerage on Face Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) under Rs. 25,000</td>
<td>Re. 0.50%</td>
</tr>
<tr>
<td>(b) Rs. 25,000 or over</td>
<td>Re. 0.25%</td>
</tr>
<tr>
<td>Loans and debentures of Port Trusts, Municipal Corporations, and similar other bodies</td>
<td>Re. 0.50%</td>
</tr>
<tr>
<td>Debentures of Joint Stock Companies</td>
<td>Re. 1.00%</td>
</tr>
</tbody>
</table>

**TABLE 2**

<table>
<thead>
<tr>
<th>Shares of Joint Stock Companies when the contract price per share</th>
<th>Brokerage Per Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does not exceed Rs. 2.50</td>
<td>Re. 0.10</td>
</tr>
<tr>
<td>Exceeds Rs. 2.50 but does not exceed Rs. 5</td>
<td>Re. 0.20</td>
</tr>
<tr>
<td>Rs. 5</td>
<td>Re. 0.30</td>
</tr>
<tr>
<td>Rs. 10</td>
<td>Re. 0.40</td>
</tr>
<tr>
<td>Rs. 15</td>
<td>Re. 0.50</td>
</tr>
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<td>Re. 0.60</td>
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</tr>
<tr>
<td>Rs. 700</td>
<td>Re. 21.00</td>
</tr>
<tr>
<td>Rs. 750</td>
<td>Re. 22.50</td>
</tr>
</tbody>
</table>

The lowest charge per contract is Rs. 5. The above scale is exclusive of service charge and does not apply to underwriting or placing of new issues.
Arbitration between members and non-members

It was clarified earlier that members of recognised stock exchanges issue two types of contracts - one as between a broker and a client and the other as between both the parties bear the superscription: 'This contract is made subject to the Rules, Byelaws and Regulations and usages of the Stock Exchange, Bombay'. The relevant byelaws are also reprinted at the back of the form. What is important to be noted is that when this contract is issued by the broker and accepted by the client, the acceptance constitutes and is deemed to be an agreement between the parties concerned that all the claims, differences and disputes between the concerned parties arising out of the transactions in which the contract relates, have to be decided by arbitration as provided in the Rules, Byelaws and Regulations of the exchange.

Arbitration machinery

It will be interesting to observe here that while the superscription on the contract form refers also to 'usages' of the stock exchange, this word is absent in the byelaws. There is, therefore, a material point as to whether a division based on the 'usages' only can stand judicial scrutiny. This arbitration machinery is also to be utilised for resolution of any disputes between a member and any person, authorised clerk or employee or any other person with whom the member shares brokerage. What is significant is that a member does not issue any contract to these persons as he is relieved from the case of the clients, perhaps in their case, due to the concept of an implied agreement for utilisation of the arbitration machinery of the stock exchange.

Because of the availability of a domestic machinery of arbitration of disputes between a member and a non-member (parties to the disputes arising out of stock exchange transactions), courts do not normally entertain such disputes and advise the parties to have recourse to it. However, of late this machinery has come under adverse criticism as it envisages the appointment of arbitrators from out of the members only. Apart from the justifiable fear that the final decision of the arbitrators may invariably tilt in favour of the member, clients have many times complained that they do not know any member other than the one with whom they have a dispute and therefore have expressed their inability to appoint their candidate. The complaint has struck a sympathetic chord in the Pater committee and they have suggested that the Committee be headed by an independent outsider chairman to allay these fears.

So in this type of arbitration, we have two arbitrators from out of the members of the exchange appointed by each party to the dispute. If one of the arbitrators is not appointed because one of the parties fails to do so for whatever reason, the Governing Board (GB) or the President is empowered to make good the vacancy. They are also authorised to fill up the vacancy in case one of the arbitrators dies or fails or neglects or refuses to act or becomes incapable of acting. If the two arbitrators differ, the matter is referred to the decision of an umpire. The authority to appoint the umpire vests in the GB or the President.

The arbitrators are required to give the award within 90 days after the reference by the parties to the reference as their representatives. At the request of any party to the reference, the arbitrators or the umpire as the case may be, will file the award in the court. On refusal to do so, the party can seek intervention of the court. If it sets aside the award, the matter is again referred to arbitration as provided in the byelaws.

Parties to the arbitration are entitled to be represented by counsel and lead evidence, oral or documentary, or hear or examine witnesses. But this is at the discretion of the arbitrators.

The arbitrators are prohibited from making any reference to any court of law on any matter arising out of or relating to the reference without obtaining prior permission of the GB.

Arbitration between members

Though for the purpose of making up its accounts, the Bombay Stock Exchange (BSE) has adopted the calendar year, its administrative year corresponds to the financial year ending March 31. Therefore the Rules lay down that in the month of March each year the GB will be constituted of sixteen members elected by the general body of members. The new Board takes office from 1st April and at its very first meeting, apart from electing the officers in charge, constitutes two standing committees - (i) an Arbitration Committee (AC) consisting of sixteen members and (a) a Defaulters' Committee consisting of six members.

The function of the AC is to settle all claims and disputes arising between members, arising out of bargains which are subject to the byelaws. In order to ensure that the decision in arbitration is absolute, the byelaws bar a member from commencing any legal proceedings against another in a court of law, in respect of such claims or disputes without the prior permission of the GB. If a member violates this provision and recovers any money or other relief, he shall hold the same in trust for the exchange and shall pay the same to the exchange to be dealt with in the manner directed by the GB.

Arbitration of disputes amongst the members is based on a three-tier system. First, the dispute is heard by two members of the Committee designated by the chairman. In case of a difference of opinion between the two, the matter is referred to a third member. This stage is an appeal to the full AC. The condition precedent to this appeal is that, unless exempted in whole or in part by the President, the applicant must deposit with the exchange in cash the full amount ordered to be paid or the securities (or the value thereof at the ruling market price) ordered to be delivered in the award.

Where the amount involved in the dispute is less than Rs. 1,000, the award of the AC is final. But where it is more, a second appeal is provided to the GB. The byelaws specifically lay down that a member who fails or refuses to submit to or abide by or carry out any award in arbitration between members shall be expelled by the GB. But no such expulsion has ever taken place, not because all awards are being implemented faithfully, but because the authorities do not generally take such deterrent action.

There is a provision for a non-member also to select this procedure but in the history of the exchange, it does not appear that any outsider has exercised this option.

Default

The word "default" has a special connotation in stock exchange parlance. According to the common dictionary meaning, "default" means "failure to pay". There may be any number of instances where a member of the stock exchange fails to pay his dues. But he is not considered as a "defaulter" unless he is declared to be so by the GB. It is because certain consequences follow as a result of such a declaration.

A member is declared a defaulter: (i) if he is unable to fulfill his engagements; or (ii) if he admits or is shown to be unable to do so; or (iii) if he fails or is unable to meet other liabilities arising out of his transactions in the exchange, or (iv) if the byelaws, by reason of the fact that the member's byelaws by reason of the fact that the member may have ceased to be in existence. However, in practice this is rarely done. Once it comes to be known that a particular member is in difficulties and unable to meet his liabilities,
interested parties move in and a compromise is brought about. The creditors forego some of their dues, the amount due to the members are collected, and with participation from the defaulting member, the matter is smoothed out. The only precaution that is taken is to freeze his card and not permit him to do fresh business as his security deposit being with the exchange is also utilized for this purpose. This action is sought to be justified on the ground that if the normal procedure is followed, the loss taken for settling the affairs of the defaulter through the Defaulters' Committee will be inordinately long and the creditors would prefer the matter to be settled expeditiously albeit by foregoing a part of the claim at the beginning itself.

This practice, however, is against Bye-law 320 of the BSE which specifically reads as:

"Compromise forbidden: A member guilty of accepting from any member anything less than a full and bona fide money payment in settlement of a debt arising out of a transaction in securities shall be suspended for such period as the GB may determine."

When a mandatory provision of the above type is not observed in practice, it is no wonder that a permissive byelaw relating to non-fulfilment of obligations to non-members has become almost a dead letter. Byelaw 317 reads as: "The GB may order a member to be declared a defaulter if he fails to meet an obligation to a member or non-member arising out of a stock exchange transaction."

A member who has been adjudicated as an insolvent is ipso facto declared a defaulter although he has no liabilities to pay in the exchange.

Consequences of default

The consequences of being declared a defaulter are severe. A member who is declared a defaulter at once ceases to be a member of the exchange and his right of membership vests in the exchange. He also loses his right of nomination.

On the notice being put up that a member has been declared a defaulter, the Defaulters' Committee moves in and takes charge of all his books of accounts, documents, papers and vouchers to ascertain the state of his affairs. He is required to hand over those to the Committee. He is also required to file with the Committee a written statement containing a complete list of his debtors and creditors and the sum owing by and to each and cooperate if for settlement of his affairs.

This does not usually happen. Once a member is declared a defaulter and loses his membership it is futile to expect him to cooperate with the authorities to settle his affairs. He will do so only if he has a chance to be readmitted. Hence, it has been suggested quite often that non-cooperation must be visited with criminal penalty.

The Committee then calls in and realises the security and margin money and securities deposited by the defaulter and recovers all monies, securities and other assets due to the defaulter by any other member. All members are enjoined to respect the requisitions of the Committee on pain of being declared defaulters themselves.

V.D. Sonde

Mr. Sonde was a former Executive Director of BSE, was Chairman of the Stock Exchange Division of the Finance Ministry and retired as Commissioner Income Tax, Bombay.

To be concluded
Default by members

V.D. Sonde

Making up the accounts of a defaulter is a bit of a complicated piece of accounting. Insofar as the settlements which are completed, there is no difficulty. Inter se liabilities between the defaulter and other members would have already been determined at the making up prices fixed for the first concluded settlement.

But at the point of time when a member is declared a defaulter, the current settlement would have already started and fresh liabilities would have been undertaken by the defaulter in addition to the liabilities carried over from the provisions settlement. It therefore becomes necessary to determine the liabilities of the defaulter for the period up to the time of his being declared to be so. Insofar as the transactions in specified shares are concerned, this is done on the basis of what are known as ‘hammer’ prices. The origin of the word ‘hammer’ in this context is not known, but perhaps it is as evocative as other words used in stock exchange terminology. ‘Hammer’ prices are fixed on the basis of the average of the prices ruling in the market within half an hour of its opening after the declaration of the default. The expression therefore indicates the arbitrariness and conclusiveness of the price so fixed.

All members who have pending transactions with the defaulter in the current settlement are required to adjust their accounts at the hammer prices which are either confirmed or altered in the making up prices at the end of the settlement. If they are altered, the accounts will have to be adjusted at the altered prices. It may be mentioned that while the accounts of the defaulter are so made up, inssofar as the other members are concerned, they will have to enter into fresh transactions in the market as the orders from their clients will have been received.

After the Committee completes its work, it will apply the net assets remaining in its hands after defraying all such costs, charges and expenses as are allowed in the byelaws in satisfying first the claim of the Exchange and the clearing house rateably to such admitted claims of the members against the defaulter.

The following claims are not entertained:

(i) Claims arising out of contracts in securities which are either not permitted or in which the claimant has either himself not paid the margin or colluded with the defaulter in its evasion;

(ii) Claims arising out of contracts which have not been compared as required in the byelaws;

(iii) Claims arising from bargains not settled by payment and delivery within the prescribed time;

(iv) Outstanding debts;

(v) Outstanding loans; and

(vi) Claims which have not been filed on time.

The defaults committee is also empowered to take proceeding in a court
of law either in its own name or in the name of the defaulter for recovering the assets of the defaulter.

Re-admission of a defaulter
A member once declared as a defaulter may be re-admitted as a member on the following conditions:
(a) He must have made out of his own resources and independently of his security and margin payment a bonafide money payment of not less than 37 paise in the rupee of the amount of loss he has incurred;
(b) If the default is due to insolvency, he must have made a payment of 100% of his dues to his creditors in or outside the market;
(c) If his default is due to the default in payment by his clients who are known to be trustworthy;
(d) If he has not been guilty of bad faith or breach of rules and byelaws;
(e) If he had kept his business within a reasonable proportion of his means or resources; and
(f) If he had been irreplaceable in his general conduct.

Re-admission cannot be re-admitted if his default has been contributed to by reckless dealings on his own account or if his conduct has been marked by indiscretion and by the absence of reasonable caution.

There is no provision in the byelaws regarding the satisfaction of the dues owed by the defaulter to his own clients. This inaccuracy is now sought to be filled by the creation of the Customers Protection Fund supported by the Pater Committee and created recently by the Bombay Stock Exchange.

Prohibitions and penalties
As is normal in the case of any institution which has rules and regulations which control the conduct of its members, the Bombay Stock Exchange also lays down a code of conduct to be followed by its members and lay down penalties for their violation. In all matters relating to disciplinary proceedings, the decision of the Governing Board is final.

The penalties prescribed are varied. In the order of their severity, they consist of (1) censure, reprimand or warning, (2) fine, (3) withdrawal of all or any membership rights, (4) suspension, and (5) expulsion.

There is an absolute prohibition on any member from entering into any of the following contracts:
(a) Carry-over contracts except in the case of specified shares;
(b) Contracts in specified shares beyond two settlement periods;
(c) Contracts in non-specified shares beyond a period of 14 days;
(d) Contracts for special delivery without the permission of the Governing Board or the President;
(e) Contracts for purchase and sale of securities which are not permitted on the exchange;
(f) Contracts for purchase and sale of prospective dividends; and
(g) Carry-over contracts where the contract notes do not show the special making-up price.

In addition to the member making himself liable to disciplinary proceedings, such contracts are deemed to be void and consequently unenforceable.

The byelaws also declare that trading for options in securities is illegal. This is in line with the provision to this effect in the Securities Contracts (Regulation) Act, 1956.

The code of conduct laid down in the byelaws is divided into three parts viz., (1) misconduct, (2) unbusinesslike conduct (3) unprofessional conduct.

Misconduct
The following constitute misconduct on the part of a member:
(a) Conviction of a criminal offence or commission of fraud or a fraudulent act which the Governing Board considers as rendering the person to be unfit to be a member.
(b) Dishonourable or disgraceful or disorderly or improper conduct on the exchange or wilfully obstructing its business.
(c) Shielding or assisting or permitting to report a member, who, within his knowledge, has committed a breach of the rules and byelaws of the exchange or a resolution or order of the Board or the President.
(d) Refusal or failure to comply with a resolution or order of the Board or the President.
(e) Failure to submit to arbitration or refusal to abide by the award.
(f) Refusal or failure to testify and produce evidence in an enquiry conducted under orders of the Board or the President.
(g) Refusal or failure to submit special returns as directed by the Board or the President.
(h) Refusal or failure to compare accounts with defaulter’s committee.
(i) Refusal or failure or making of misleading statements in the returns submitted to the clearing house.
(j) Filing of frivolous, vexatious or malicious complaints.
(k) Failure to pay subscription, fees, fine or penalty etc.

Unbusinesslike conduct
The following are deemed to be unbusinesslike conduct:
(a) Carrying on business in fictitious names;
(b) Entering into fictitious dealings;
(c) Carrying on business with the purpose of upsetting the equilibrium of the market or bringing about a condition of demoralisation in which prices will not fairly reflect market value;
(d) Circulation of rumours of a sensational character;
(e) Carrying on reckless or unreasonably or unbusinesslike dealings beyond capacity.

Unprofessional conduct
The following constitute unprofessional conduct:
(a) Keb trading;
(b) Transactions in securities in which dealings are not permitted;
(c) Business with a defaulter client;
(d) Business with an insolvent;
(e) Carrying on business whilst under suspension;
(f) Carrying on business with suspended, expelled or defaulter members;
(g) Carrying on business on behalf of a partner of a firm
(h) Carrying on business with or for an employee of another member without the latter’s written permission;
(i) Carrying on business on behalf of an employee of the exchange;
(j) Carrying on business for a non-member broker;
(k) Advertising for business purposes;
(l) Exceeding margin requirements;
(m) Deviating from charging or sharing brokerage as laid down in the byelaws.

It will indeed be a Utopian situation if the code of conduct is scrupulously followed by the stock brokers or if the exchange authorities are able to take steps to implement it. But both these assumptions remain in the realm of fancy and one sees a situation where the code is breached more often than observed. This is because, though the stock brokers take pride in calling themselves professionals, in practice their behaviour and conduct is that of businessmen. And, in business, personal gain is the main motivating force with morality taking a back seat. In the place of a strict enforcement of the code of conduct, it is of desire for a compromise or a desire to have the problem out of the way smoothly. Very few of the members are cognizant of the requirements of the byelaws and a substantial number of them see the exchange as an institution which provides them with an opportunity to make their living. Perhaps the position will improve if there is an increased awareness amongst them of their social responsibilities.

This series has now come to an end. A stated earlier, the subject has been developed based on the rules, byelaws, regulations and practices of the Bombay Stock Exchange with which I am familiar. The byelaws of the other exchanges are more or less similar. These are now changing in the light of the report submitted by the Patil Committee. But the changes are not substantial. There will be changes in the form but changed in the content will only be marginal. The basic structure of the market will continue to be the same.