

## A CRITICAL ANALYSIS OF THE REGULATORY OVERSIGHT ON THE SECURITIES SETTLEMENT SYSTEM IN INDIA

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**Abstract:** *This research paper endeavors to identify or rather investigate the point as to whether and to what extent do the regulatory provisions enacted by the long-term securities market regulator in India i.e. The Securities and Exchange Board of India viz. SEBI helps in controlling and disciplining the institutional players operating in the securities trade settlement domain who are primarily responsible for ensuring and guaranteeing the settlement of trades executed on the stock exchanges in India. The article also investigates the point as to how far the securities market regulations helps in exercising control or plays an effective role in disciplining the various market players, particularly those operating in the area settlement of trades executed on a stock exchange. The article also highlights the rationale behind the enactment of such regulations and suggests the road ahead for the regulator i.e. SEBI. In its concluding part the research paper makes brief comparison of regulations prevalent in Indian jurisdiction with that of UK and USA. This comparative study has been undertaken by the researcher with a view to suggest some positive regulatory measures which may be considered to be enacted by the market regulator i.e. SEBI in India.*

It is a well accepted premise in the fiscal domain that a competitive, stable and a sustainable long-term securities market provides a strong impetus to economic growth and benefits the society enormously. A fully liquid long-term securities market coupled with a well functioning and stronger banking system is central to a successful modern economy.<sup>2</sup> The banking systems together with securities market system taps savings, surpluses from common households and business houses, and makes the same available for business ventures and projects that are in need of funding.

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<sup>1</sup> Roy Sujata, Assistant Professor of Law at The West Bengal National University of Juridical Sciences, Kolkata; url: <http://www.nujs.edu/> accessed on the 15<sup>th</sup> of February, 2017.

<sup>2</sup> Paper published by the Association for Financial Markets in Europe i.e. AFME titled *Post Trade Explained* available at file:///C:/Documents%20and%20Settings/user/Desktop/AFME\_PostTradeExplained\_Jan2015\_W.pdf accessed on 25<sup>th</sup> of Jan. 2016. AFME's official url is <http://www.afme.eu/> accessed on 25<sup>th</sup> of Jan. 2016.

This ensures that there is smooth flow of surplus savings of common households to capital deficit areas of economy. This mechanism also helps ensuring that there is a balanced and sustainable growth of all sectors in a flourishing economy. A well functioning securities market also helps corporate bodies, investors and institutions to hedge risks and plan for their financial future.

The securities market has two interdependent and inseparable segments, the new issues (commonly addressed as the 'primary') market and the stock (commonly addressed as the 'secondary') market. The primary market provides the channel for creation and sale of new securities, while the secondary market deals in securities previously issued to buyer(s) in the market. The Stock market or Equities market is the one where listed securities are traded in the secondary market.<sup>3</sup> Many authors also consider **primary markets** as the markets for '**original sale of securities**' as the issuer company creates and sells the securities to the buyers directly in this market and explain **secondary markets** to be markets for '**subsequent sale of securities**'.

All economic/commercial transactions must result in actual delivery of goods and services to the parties as agreed upon and as per the terms of agreement between the parties. Similarly in securities market the buyer of the securities must actually receive the securities that he bought from the market either in physical form or in electronic form<sup>4</sup> i.e. the securities are credited to his demat account maintained with the depository participant i.e. DPs. **In India the Depository Participants are regulated by The Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996. Section 30 of The Securities and Exchange Board of India Act, 1992 and Section 25 of the Depositories Act, 1996 enables and empowers SEBI to enact regulations and regulate DPs in India.**<sup>5</sup> These regulations deal with registration of Depositories and

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<sup>3</sup> There are no statutory definitions provided to the terms primary and secondary markets under any statute law in India. Hence reliance has been placed on the explanation provided by one of the major stock exchanges accounting for the largest volume of trade in securities in India. The National Stock Exchange of India's explanation to the primary and secondary market trade is available at

<http://www.nseindia.com/products/content/equities/equities/equities.htm> and also in pp 15 of The Indian Securities Market Review (ISMR) 2014 published by The NSE, a copy of the ISMR 2014 is also available at

<http://www.nseindia.com/research/dynaContent/ismr.htm> accessed on 26th of Jan. 2016

<sup>4</sup> Section 29 sub-section(1) cl. (a) of The Companies Act, 2013 read with rule 9 of The Companies (Prospectus and Allotment of Securities) Rules, 2014 prescribes that every company making a 'public offer' of securities is required to issue the securities only in dematerialised form. A copy of the legislation in electronic form and the said rule is also available at <http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf> and at

[http://www.mca.gov.in/Ministry/pdf/NCARules\\_Chapter3.pdf](http://www.mca.gov.in/Ministry/pdf/NCARules_Chapter3.pdf) accessed on 26th of Jan. 2016

<sup>5</sup> A copy of The Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 is also available at the official website of SEBI i.e. <http://www.sebi.gov.in/acts/dpregu.pdf> accessed on 26th of Jan. 2016

Participants, their internal monitoring systems, their review, evaluation of systems and controls, manner of keeping records etc. Any default in the post trade settlement process in the secondary market by either of the parties to the trade (i.e. a buyer or seller of securities) in making actual payment or actual delivery of securities following a trading transaction undertaken on the exchange, not only leads to enhancement in the risks associated with investment in such a market where trade settlement is not guaranteed, but may also damage the investors' confidence in long run, which is considered to be a deeper damage done to the system and an irreparable loss caused. And if the default is larger in size then it ultimately leads to a huge market crash which is fatal for any growing economy like India. This is the reason that all developed securities market guarantees enforcement of economic obligations/ liabilities undertaken by the parties to the trade operations carried out on a stock exchange.

### **Indian Market Segments:**

*The securities market has essentially three categories of participants – the issuer of securities, the investors in the securities and the intermediaries.*<sup>6</sup> The issuers are the borrowers or deficit savers, who issue securities to raise funds. The investors, who are surplus savers, deploy their savings by subscribing to these securities. The intermediaries are the agents who match the needs of the users and the suppliers of funds for a commission. These intermediaries function to help both the issuers and the investors to achieve their respective goals.<sup>7</sup>

The securities issued to the public in primary markets are issued by public limited companies or by government agencies. The resources in this kind of market are mobilized either through a public

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<sup>6</sup> *Overview of Indian Securities Markets* also available at <http://nism.ac.in/certification/index.php/studentzone> accessed on the 13th of March, 2016. The National Institute of Securities Market (i.e. NISM) is an educational initiative and a public trust established in the year 2006 by the securities market regulator in India i.e. SEBI and offers various courses on various aspects of securities markets. The Institute carries out a wide range of capacity building activities at various levels and currently has six 'Schools of Excellence' operating under its aegis. The Institute is located at the NISM Bhavan, Navi Mumbai, with url: <http://nism.ac.in/> accessed on the 13<sup>th</sup> of March, 2016.

<sup>7</sup> Supra FN 5

issue<sup>8</sup> or through a private placement<sup>9</sup> route. **The term ‘public issue’ is legally defined to mean both the Initial Public offer (IPO)<sup>10</sup> and Further Public Offer (FPO)<sup>11</sup> according to section 2(1) (zc) of The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009. The SEBI (ICDR) Regulations, 2009 defines an ‘initial public offer’ as an offer of specified securities by an unlisted issuer<sup>12</sup> to the public for subscription and includes an ‘offer for sale’ of securities.<sup>13</sup> Likewise, The SEBI (ICDR) Regulations, 2009 defines ‘further public offer’ as an offer of specified securities<sup>14</sup> by a listed issuer to the public for subscription and includes an offer for sale.<sup>15</sup> According to SEBI (ICDR) Regulations, 2009 an issuer is a person who makes an offer of specified securities in the market.<sup>16</sup> If any person is allowed to subscribe for the issue, it is a public issue; **if the issue is made available only to a select group of persons in accordance with section 42 of the Companies Act, 2013 it is known as private placement.** So far as the applicability of The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 is concerned, the same are applicable<sup>17</sup> to all public issues, a preferential issue,<sup>18</sup> rights issue<sup>19</sup> where the aggregate value of securities offered by an issuer is 50 lakhs or more, a qualified institutional placement by a listed issuer, issue of bonus shares by a listed issuer, and an issue of Indian Depository Receipts by an issuer and regulates the various processes involved in making of such an issue. Issues are classified as**

under:

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<sup>8</sup> Regulation 2, sub-regulation (1) cl.(zc) of The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, commonly referred to as SEBI (ICDR) Regulations, 2009. A copy of the SEBI (ICDR) Regulations is also available at <http://www.sebi.gov.in/guide/sebiidcreg.pdf> accessed on 26th of Jan. 2016

<sup>9</sup> Section 42 of the Companies Act, 2013 read with rule 14 of The Companies (Prospectus and Allotment of Securities) Rules, 2014 deals issuance of securities through private placement route.

<sup>10</sup> Regulation 2, sub-regulation(1), cl. (p) of the SEBI (ICDR) Regulations, 2009

<sup>11</sup> Regulation 2, sub-regulation (1), cl.(n) of the SEBI (ICDR) Regulations, 2009

<sup>12</sup> Regulation 2, sub-regulation (1), cl (zm) of the SEBI (ICDR) Regulations, 2009

<sup>13</sup> Supra FN 7

<sup>14</sup> Regulation 2, sub-regulation (1), cl (zj) of the SEBI (ICDR) Regulations, 2009

<sup>15</sup> Supra FN 8

<sup>16</sup> Regulation 2, sub-regulation (1), cl (r) of the SEBI (ICDR) Regulations, 2009

<sup>17</sup> Regulation 3 of The SEBI (ICDR) Regulations, 2009 prescribes the applicability of the Regulations to various types of securities market issues.

<sup>18</sup> Regulation 2, sub-regulation (1), cl.(z) of The SEBI (ICDR) Regulations, 2009 defines the term ‘preferential issue’ of securities

<sup>19</sup> Regulation 2, sub-regulation (1), cl.(zg) of The SEBI (ICDR) Regulations, 2009 defines the term ‘rights issue’ of securities





Source: SEBI's FAQ on 'Issues by Companies in India'<sup>20</sup>

There are **two major types of issuers of securities**—corporate entities, who issue mainly debt and equity instruments, and the government (central as well as state), which issues debt securities (dated securities and treasury bills). From an investor's point of view his investment in a corporate entity's equity or convertible instrument is characterised by relatively higher financial risks as there are no guaranteed economic returns from the issuer entity unlike other competing instruments like debt instruments and the government securities where the holder of debt instrument receives guaranteed fixed rate of interest [as agreed upon by the borrower entity which could be either or both the corporate entity or the Government of states or the Centre) and the lender/ investor of the debt instruments] as a return on his investment from the issuer. The legal/ enforceable right of a lender to a corporate entity or the government, this helps making the debt instruments relatively more secured and also makes the same comparatively more attractive and much in demand for the investing public.

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risks and returns. Once new securities are issued in the primary market, they are traded in the stock (secondary) market. **The secondary market operates through two mediums, namely, the over-the-counter (OTC) market and the exchange-traded market.** The OTC markets are informal markets where trades are negotiated. Most of the trades in

<sup>20</sup> SEBI's FAQ on 'Issues by Companies in India' available at <http://www.sebi.gov.in/faq/subsection.pdf> accessed on 26th of Jan. 2016

government securities<sup>21</sup> take place in the OTC market. According to The Securities Contracts (Regulation) Act, 1956 and also The Public Debt Act, 1944 the term 'government security' means a security created and issued by the central government or a state government for the purpose of raising a public loan and having one of the forms which is namely a promissory notes payable to order (promissory notes also includes treasury bills)<sup>22</sup>, a bearer bond payable to bearer or any other form thus prescribed.<sup>23</sup> All the spot trades<sup>24</sup> where securities are traded for immediate delivery and payment occur in the OTC market. The other option is to trade using the infrastructure provided by the stock exchanges. The exchanges in India follow a systematic settlement period. All the trades taking place over a trading cycle (day = T) are settled together after a certain time (T + 2 day). The trades executed on exchanges are cleared and settled by a clearing corporation.

### **Clearing Corporations and their regulation:**

Section 8A of the Securities Contracts (Regulation) Act, 1956 deals with the functions, duties and overall regulation of clearing corporations associated with recognised stock exchanges in India. Section 8A has been inserted to the Securities Contracts (Regulation) Act, 1956 through the enactment of the Securities Laws (Amendment) Act, 2004.<sup>25</sup>

According to Shri M S Sahoo,<sup>26</sup> prior to the enactment of the Securities Laws (Amendment) Act, 2004 the securities laws did not explicitly recognise existence of clearing corporation. The

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<sup>21</sup> Sec. 2(b) of The Securities Contracts (Regulation) Act, 1956 defines 'government security'. A copy of the legislations in electronic form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1444898310496.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1444898310496.pdf) accessed on the 20th Feb. 2016. Also Sec. 2 of The Public Debt Act, 1944 defines the term 'government security'. A copy of The Public Debt Act, 1944 in electronic form is also available at [http://finmin.nic.in/the\\_ministry/dept\\_eco\\_affairs/budget/P.D.ACT1944.pdf](http://finmin.nic.in/the_ministry/dept_eco_affairs/budget/P.D.ACT1944.pdf) accessed on the 20th of Feb. 2016

<sup>22</sup> Sec 2(4) of The Public Debts Act, 1944. A copy of the legislation in electronic form is also available at [http://finmin.nic.in/the\\_ministry/dept\\_eco\\_affairs/budget/P.D.ACT1944.pdf](http://finmin.nic.in/the_ministry/dept_eco_affairs/budget/P.D.ACT1944.pdf) accessed on the 23rd of Feb. 2016

<sup>23</sup> Supra FN 18

<sup>24</sup> Sec2(i) of The Securities Contracts (Regulation) Act, 1956 defines 'spot delivery contract'. A copy of The Securities Contracts (Regulation) Act, 1956 in electronic form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1444898310496.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1444898310496.pdf) accessed on 20th of Feb. 2016.

<sup>25</sup> A copy of the Securities Laws (Amendment) act, 2004 is also available in digital form at [http://www.prindia.org/uploads/media/vikas\\_doc/docs/acts\\_new/1167484504\\_THE\\_\\_SECURITIES\\_\\_LAWS.pdf](http://www.prindia.org/uploads/media/vikas_doc/docs/acts_new/1167484504_THE__SECURITIES__LAWS.pdf) accessed on the 31st of May, 2016

<sup>26</sup> Sahoo M S, A Historical Perspective of Securities Laws, a copy of the article in digital/ downloadable form is also available at [www.icsi.edu/webmodules/.../31nc/historicalperspectiveofsecuritieslaws-mssahoo.doc](http://www.icsi.edu/webmodules/.../31nc/historicalperspectiveofsecuritieslaws-mssahoo.doc) accessed on 31st of May, 2016. Mr. Sahoo has authored number of articles in the securities market area. Mr. Sahoo also worked extensively for more than three decades in the securities /capital markets area and has also served as a Whole Time Member of SEBI. A brief profile view of Mr. Sahoo is also available at

securities laws then mentioned only about trading and not about settlement, which is left to byelaws of the exchanges. The byelaws were supposed to provide for a clearing house (not Clearing Corporation) for settlement of securities transactions. Section 9 of the Securities Contracts (Regulation) Act, 1956 empowers a recognised stock exchange in India to make or frame its own byelaws.<sup>27</sup> The byelaws enacted by the stock exchanges may also be applicable to a clearing house attached to the stock exchange as per section 9(2) of the Securities Contracts (Regulation) Act, 1956.<sup>28</sup> Prior to the enactment of the Securities law (Amendment) Act, 2004 the anonymous order book ushered in by screen based trading system did not allow participants to assess the counter party risk. It was, therefore, felt necessary that the exchanges form a clearing corporation to provide novation and settlement guarantee. Converting clearing houses into clearing corporations helps removing conflict of interests situation (often it has been observed that members of clearing houses, by virtue of their membership may be in possession of important information which may be unavailable to the common investors, this might create a conflict of interest situation for the individual member of the clearing corporation), greater management accountability, transparency and instill market discipline.

When a buy order in an exchange matches with a sell order, a trade in securities is generated. It is now that the central counterparty steps in or intervenes between the parties i.e. the buyer and the seller and acts as a buyer to every seller and a seller to every buyer, thus guaranteeing settlement of trades. **This process is undertaken by the clearing corporations in securities markets and is known as a 'novation'.** The Clearing Corporations maintains a fund for guaranteeing securities trade settlements and in the event of a buyer or seller of securities defaulting, the Clearing Corporation absorbs the risk and makes the payment or delivers securities as the case may be.

The Securities Laws (Amendment) Act, 2004 inserted a new section to provide that an exchange may, with the approval of SEBI, transfer the duties and functions of a clearing house to a clearing

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<https://www.icsi.edu/portals/0/BIO%20DATA%20OF%20CS%20M%20S%20SAHOO%20-%20SECRETARY%20ICSI.pdf> accessed on the 31<sup>st</sup> of May, 2016.

<sup>27</sup> Refer to section 9 of the Securities Contracts (regulation) Act, 1956. The section 9 of the Securities Contracts (regulation) Act, 1956 provides for the making of bye-laws by the recognised stock exchanges in India but the draft byelaws shall come into force only after the due approval by the regulator i.e. the Securities and Exchange Board of India (i.e. SEBI) according to section 9 of the Securities Contracts (Regulation) Act, 1956. A copy of the Securities Contracts (Regulation) Act, 1956 is also available in digital form for reference at

<http://www.sebi.gov.in/acts/contractact.pdf> accessed on the 12th of July, 2016

<sup>28</sup> Ibid

corporation for the purpose of the periodical settlement of contracts and differences there under, and the delivery of and payment for securities. SEBI was empowered by the Securities laws (Amendment) Act, 2004 to approve such transfer if it is in public interest or in the interest of trade. It is mandate by the Amendment Act <sup>29</sup> that every clearing corporation is a company and its byelaws must be approved by SEBI. The various provisions in the SCRA such as grant and withdrawal of recognition, supersession of management, suspension of business etc. applicable to stock exchanges shall, *mutatis mutandis*, apply to clearing corporations.

The Stock Exchanges and their associated clearing corporations are regulated by the SEBI in India. The primary legislation regulating the stock exchanges and the clearing corporations in India are the *Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012*<sup>30</sup>, the *Securities Contracts (Regulation) Act, 1956*<sup>31</sup> and the *Securities Contracts (Regulation) Rules, 1957*. In addition, the stock exchanges and their respective clearing corporations also frame their own bye-laws, confirming to the broad parameters laid down by the securities market regulator in India i.e. SEBI. The bye-laws apply to the various segments and participants operating under the supervision of the stock exchange. Instances of some of the bye-laws promulgated by the National Stock Exchange of India Limited (NSEIL)<sup>32</sup> and the associated clearing corporation i.e. National Securities Clearing Corporation Limited (NSCCL)<sup>33</sup> are the National Stock Exchange of India Rules<sup>34</sup>, the National Securities Clearing Corporation limited

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<sup>29</sup> *Supra* FN 24

<sup>30</sup> A copy of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 is also available in digital form at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1340272091708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1340272091708.pdf) accessed on the 24th of May, 2016.

<sup>31</sup> A copy of the Securities Contracts (Regulation) Act, 1956 is also available in digital form at <http://www.sebi.gov.in/acts/contractact.pdf> accessed on the 24th of May, 2016.

<sup>32</sup> The National Stock Exchange of India Limited (NSEIL) is a company limited by shares and is registered as a stock exchange in India. url : [https://www.nseindia.com/index\\_nse.htm](https://www.nseindia.com/index_nse.htm) accessed on the 25th of May, 2016.

According to the latest statistics available on SEBI's website i.e. at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1462441113708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1462441113708.pdf) , pp 16, of the Handbook of Statistics uploaded on SEBI's official website and accessed on the 25<sup>th</sup> of May, 2016, the NSEIL alone accounted for more than 70 percent of the total trade in securities in the country i.e. India in the financial year 2014-15.

<sup>33</sup> NSCCL stands for National Securities Clearing Corporation Limited and is the clearing corporation attached with the National Stock Exchange of India Limited, url :

[https://www.nseindia.com/supra\\_global/content/nscc/about\\_nscc.htm](https://www.nseindia.com/supra_global/content/nscc/about_nscc.htm) accessed on the 25th of May, 2016

<sup>34</sup> A soft copy of the NSEIL Rules is also available in digital form for reference at

<https://www.nseindia.com/global/content/regulations/NSErules.pdf> accessed on the 25th of May, 2016



Rules<sup>35</sup>, National Stock Exchange of India Limited Bye-laws<sup>36</sup>, National Securities Clearing Corporation Limited Bye-laws<sup>37</sup>, BSE Limited Regulations (Cash Segment)<sup>38</sup>, BSE Limited Regulations (Derivative Segment)<sup>39</sup>, BSE Limited Bye-laws<sup>40</sup>, the Indian Clearing Corporation Limited<sup>41</sup> (i.e. ICCL, the clearing corporation associated with the Bombay Stock Exchange) also has prescribed certain mandatory clearing procedures to be followed by the ICCL and the market participants like the procedure for deposit and withdrawal of Government securities etc.<sup>42</sup> However, unlike the NSCCL, the ICCL prescribes detailed formats of various applications and other functional operations to be filled in and submitted by the members and other parties associated with the clearing corporation rather than detailed rules, regulations and bye-laws as prescribed by the NSCCL. The bye-laws of the Clearing Corporations though are drafted / prepared by the Clearing Corporation themselves, but the same is not promulgated or notified unless the bye-laws have been duly vetted and approved by the market regulator, SEBI.<sup>43</sup> Or in other words, the bye-laws of the stock exchanges and their respective clearing corporations in India are published and made available in the public domain only after the same has been duly approved by the securities market regulator, SEBI. In this process or way the securities market regulator, i.e. SEBI grants approval to the bye-laws framed and submitted for its due approval. While granting approval to the bye-laws, SEBI satisfies itself with regard to the point that the bye-laws would serve the best interest of trade, cater to public interest by enabling smooth and speedy transfer of

<sup>35</sup> A soft copy of the NSCCL Rules is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMrules.pdf> accessed on the 25th of May, 2016

<sup>36</sup> A soft copy of the NSEIL Bye-laws is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSEbyelaws.pdf> accessed on the 25th of May 2016

<sup>37</sup> A soft copy of the NSCCL Bye-laws is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMbyelaws.pdf> accessed on the 25th of May, 2016

<sup>38</sup> The Bombay Stock Exchange is the oldest bourse established in Asia in the year 1875 (Source : <http://www.bseindia.com/static/about/introduction.aspx?expandable=0> accessed on the 26<sup>th</sup> of May, 2016), It is known as BSE as it has adopted its initial i.e. BSE as its name (Source: <http://www.bseindia.com/static/about/logo.aspx?expandable=0> accessed on the 26<sup>th</sup> May, 2016 ); url of BSE: <http://www.bseindia.com/> accessed on the 26<sup>th</sup> of May, 2016. Some of the bye-laws of the BSE are available in digital form and are also accessible and downloadable from <http://www.bseindia.com/members/downloads.aspx?expandable=9> accessed on the 26<sup>th</sup> of May 2016.

<sup>39</sup> Ibid

<sup>40</sup> Ibid

<sup>41</sup> The ICCL is a wholly owned subsidiary of the Bombay Stock Exchange Limited (BSE). The ICCL offers clearing services to the BSE (Source: <http://www.icclindia.com/static/about/companyprofile.aspx> accessed on the 26th of May, 2016)

<sup>42</sup> Supra FN 33

<sup>43</sup> Section 8A(2) of the Securities Contracts (Regulation) Act, 1956. A soft copy of the Securities Contracts (Regulation) Act, 1956 is also available in its digital form at <http://www.sebi.gov.in/acts/contractact.pdf> accessed on the 24th May, 2016

financial resources and would also help regulating the stock exchanges and Clearing Corporation optimally thereby enhancing the efficiency and smooth functioning of the Clearing Corporation and its various participants.<sup>44</sup> *The clearing corporation acts as a counterparty and guarantees settlement.*

### **Forward Contracts Market:**

A variant of the secondary market is the forward market, where securities are traded for future delivery and payment. Forward market is a market in which assets are bought and sold for future delivery. It is a market that deals with transactions (i.e. sale or purchase of assets) that are contracted (vide a forward contract note) at the present date and time but are implemented at a future date and time. Thus a forward market is essentially a market where forward contracts are contracted and formed between the parties. According to the provisions of the repealed<sup>45</sup> legislation i.e. Forward Contracts (Regulation) Act, 1952, a forward Contract<sup>46</sup> is a contract for delivery of goods and which is not a ready delivery contract.<sup>47</sup> According to the definition of the term 'ready delivery contract' as provided by one of the oldest statutes regulating the Bombay stock exchange viz. The Bombay Securities Control Act, 1925<sup>48</sup> a "ready delivery contract" in its simplest form means "a contract for the purchase or sale securities for performance of which no time is specified and which is to be performed immediately or within a reasonable time". With regard to the question as to what constitutes 'reasonable time' would depend upon the facts and circumstances of the individual matter or the case in hand.

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<sup>44</sup> Section 8A(3) of the Securities Contracts (Regulation) Act, 1956. A soft copy of the Securities Contracts (Regulation) Act, 1956 is also available in its digital form at <http://www.sebi.gov.in/acts/contractact.pdf> accessed on the 24th May, 2016

<sup>45</sup> A copy of the press release by the Government of India repealing the Forward Contracts (Regulation) Act, 1952 is also available at <http://pib.nic.in/newsite/PrintRelease.aspx?relid=126576> accessed on the 30<sup>th</sup> of May, 2016. A copy of the gazette notification repealing the Forward Contracts (Regulation) Act, 1952 is also available at <http://egazette.nic.in/WriteReadData/2015/165640.pdf> accessed on the 30<sup>th</sup> of May, 2016

<sup>46</sup> Section 2(c) of the erstwhile Forward Contracts (Regulation) Act, 1952 is the only piece of legislation that defined the term 'forward contract'. A copy of the Forward Contracts (Regulation) Act, 1952 is also available at [http://www.fmc.gov.in/show\\_file.aspx?linkid=FCRA\\_ACT-886692219-547043779.pdf](http://www.fmc.gov.in/show_file.aspx?linkid=FCRA_ACT-886692219-547043779.pdf) accessed on the 30<sup>th</sup> of May, 2016

<sup>47</sup> Section 2 (ea) of the Securities Contracts (Regulation) Act, 1956, recently amended through the enactment of section of section 133 of the Finance Act, 2015 defines the term 'ready delivery contract' The term has been originally defined under section 2 (i) of the Forward Contracts (Regulation) Act, 1952.

<sup>48</sup> Section 3(4) of the Bombay Securities Control Act, 1925 defines a ready delivery contract. A copy of the legislation in its digital form is also available at <http://www.sebi.gov.in/History/bombayact.pdf> accessed on the 31<sup>st</sup> of May, 2016

The hon'ble Supreme Court of India in the case of *Madhubhai Amathalal Gandhi Vs. The Union of India (UOI)*<sup>49</sup> while emphasizing the need for an efficient and well functioning stock market system in an economy observed that there are three modes of dealing in shares and stocks, namely, **(1) spot delivery contract**, i.e., a contract which provides for the actual delivery of securities on the payment of a price thereof either on the day of the contract or the next day, excluding perhaps the period taken for the dispatch of the securities or the remittance of the money from one place to another; **(2) ready delivery contract**, which means a contract for the purchase or sale of securities for the performance of which no time is specified and which is to be performed immediately or within a reasonable time. The question as to what would constitute 'reasonable time' would depend upon facts and circumstances of each case; **(3) forward contracts**, i.e., contracts, where under the parties agree for their performance at a future date.

The Forward Contracts (Regulation) Act, 1952 that defined the 'ready delivery contract' and 'forward contracts' has recently been repealed last year, by virtue of the coming into force of section 132 of the Finance Act, 2015 on the 29<sup>th</sup> of Sept. 2015.<sup>50</sup> Through the enactment of sections 131, 132 and 133 of The Finance Act, 2015 some of the major enabling provisions of securities law were inserted by way of amendment to the currently existing legislation for the time being in force i.e. the Securities Contracts (Regulation) Act, 1956.<sup>51</sup> These legal provisions (i.e. sections 131, 132 and 133 of The Finance Act, 2015) facilitated the repeal of the Forward Contracts (Regulation) Act, 1952 and the transfer of the regulatory control over the commodity derivatives entirely to the Securities and Exchange Board of India (i.e. SEBI) resulting in the ultimate merger of the erstwhile commodities market regulator in India i.e. Forward Markets Commission (FMC) with the securities market regulator i.e. the Securities and Exchange Board of India (i.e. SEBI).

A forward contract is a privately negotiated non-standardised contract between two parties to buy or sell an asset at a specified future time and date at a pre-determined price agreed between the parties at the present date and time. Or in other words, a forward contract is a contract two parties to buy or sell an asset at a specified future date and time at a price agreed upon between the parties

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<sup>49</sup> MANU/SC/0023/1960

<sup>50</sup> A copy of the Finance Act, 2015 is also available at <http://www.cbec.gov.in/resources/htdocs-cbec/finact2015.pdf> accessed on the 30th of May, 2016

<sup>51</sup> A copy of the Securities Contracts (Regulation) Act, 1956 in digital form is also available at <http://www.sebi.gov.in/acts/contractact.pdf> accessed on the 1st of June, 2016

now ( or at present date and time).<sup>52</sup> This is in sharp contrast to a spot contract, which is an agreement to buy or sell an asset now (or at present date and time). Initially it costs nothing to enter a forward contract. The party agreeing to buy the underlying asset in the future assumes a **long position**, and the party agreeing to sell the asset in the future assumes a **short position**. Hence the buyer in this case holds a **long forward contract** and the contract held by the seller would be known as the **short forward contract**. The price agreed between the parties at which the delivery of the underlying asset would take place at a future time and date is called the **delivery price**, which is equal to the forward price at the time the (forward) contract is getting entered into. Further, the two parties to the forward contract are expected to bear each other's credit risk, which is not the case with a futures contract. Also, since the forward contracts are not exchange traded, there is no marking to market requirement, which allows a buyer to avoid almost all capital outflows initially. The forward price is the agreed upon price of an asset in forward contract.

In addition there is also another term related to forward contracts called the **non-deliverable forward (or the NDF)**. A non-deliverable forward is a contract settled not by actual delivery of the underlying asset but by the exchange of the difference in prices of the underlying asset as per the contract rate and some reference rate which may be the rate prescribed by the Reserve Bank of India or so. There are primarily **two fundamental reasons behind entering into a forward contract** by the parties. **They are hedging and speculation.**<sup>53</sup> Simply put, hedging can be explained to be an attempt made by a party to the contract that protects him by minimizing the possible risk of sustaining a huge financial loss in the event of any adverse change in the price of the underlying asset. Speculation on the other hand is nothing but entering into a forward contract with a motive to make profit arising out of the fluctuations in the prices of the underlying asset in the market over a period of time. A variant of the forward market is the **Futures and Options market**. Presently, there are only two major stock exchanges in India that provide for trading in Futures and Options —the National Stock Exchange of India Ltd. (NSE) and the Bombay Stock Exchange (BSE).

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<sup>52</sup>The explanation is also available at <http://definitions.uslegal.com/f/forward-contract/> accessed on the 30<sup>th</sup> of May, 2016

<sup>53</sup> Singh J, *Difference between Spot market and Forward Market/Foreign Exchange*, also available at <http://www.economicdiscussion.net/difference-between/difference-between-spot-market-and-forward-market-foreign-exchange/615> accessed on the 30<sup>th</sup> of May, 2016.



**Regulatory and Settlement issues in Forward Contracts:**

Forward market is further categorized into the commodities forward contract and the securities forward contracts. Initially the commodities forward contract market has been regulated by the Forward Markets Commission (FMC). The legislation regulating the commodities forward contracts market in India until the year 2015 has been the Forward Contracts (Regulation) Act, 1952 and the Forward Contracts (Regulation) Rules, 1954.

Forward contracts market poses number of regulatory challenges to the regulator. **Since the forward contracts are not standardised and are exchange traded, there is greater counterparty risk in guaranteeing the settlement of forward contracts, the securities market regulator i.e. SEBI while taking over the supervision/ regulation of the commodities market<sup>54</sup> decided to ban the fresh issue of forward contracts in commodities.<sup>55</sup>** According to the SEBI's press release<sup>56</sup> in the related issue the reason cited for banning the fresh issuance of the forward contracts in commodities market by SEBI is that the regulator endeavors to curb speculative participation and market volatility, instilling proper market discipline in the commodities forward market.<sup>57</sup>

According to the erstwhile piece of legislation i.e. the Forward Contracts (Regulation) Act, 1952 which regulated the trading activity in the commodities market in India, **a forward contract is a contract that is finally settled, resulting in the actual delivery of goods.** A forward contract is traded over-the-counter and is much unlike the futures contract where the buyer can opt for the settlement of trade in futures contract through payment of cash as well. This is done by paying a cash consideration equivalent to the amount constituting or accounting for the financial loss sustained by the buyer in the absence of an actual delivery of the commodity traded at the agreed price to the buyer. This is also due to the fluctuations in market price of the commodity. As the futures contracts allow the parties to settle trades through the payment of difference in price of the

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<sup>54</sup> The erstwhile commodities market regulator i.e. Forward Markets Commission in India formally merged with the securities market regulator in India on the 28<sup>th</sup> of Sept. 2015. A copy of the press release of the said merger between the two regulators is also available in digital form at [http://www.sebi.gov.in/cms/sebi\\_data/pdffiles/32029\\_t.pdf](http://www.sebi.gov.in/cms/sebi_data/pdffiles/32029_t.pdf) accessed on the 3rd of June, 2016

<sup>55</sup> A copy of the press release by the SEBI banning the fresh issue of commodities forward contracts is also available at [http://www.sebi.gov.in/cms/sebi\\_data/pdffiles/32835\\_t.pdf](http://www.sebi.gov.in/cms/sebi_data/pdffiles/32835_t.pdf) accessed on the 1st of June, 2016

<sup>56</sup> Ibid

<sup>57</sup> Ibid

commodity traded on the exchange, it is easier for the exchange to guarantee the ultimate settlement of the trade in commodities futures. This phenomenon occurs because of the reason that the entities that are not producers or buyers of the physical commodity are major participants in the commodities futures market, where contracts are settled in cash. But since forward contracts are compulsorily settled by delivery of commodities, only genuine users participate in this segment.

Forward contracts were introduced in the commodities market in the month of September, 2014 by the erstwhile regulator of commodities market i.e. Forward Markets Commission, but they are not permitted in securities stock exchanges. *However, the process of trading in forward contracts lacked a strong settlement guarantee mechanism in the shape of full trade guarantee and zero counterparty risk – the two essential characteristic component of any exchange traded product.* The commodities market participants blamed the inability of the system to provide for a strong settlement mechanism for dealings in forward contracts to structural lacunas, issues and incompetency's of the commodities exchanges and the then regulator of the commodities market i.e. the Forward Markets Commission to implement the same.

Globally, the bulk of the forward contracts in commodities happen outside the exchange platform. Only futures and options are traded on leading commodity exchanges such as those belonging to the Chicago Mercantile Exchange (CME Group) and the London Metal Exchange (LME).

According to critics, the capital market regulator i.e. SEBI took the step to ban the issue of fresh forward contracts in commodities because it did not want to start regulating the commodities market with grey areas like the forward contracts which was already reeling with regulatory issues for quite some time before SEBI took over the supervision of commodities market. In India, *the National Commodity and Derivatives Exchange Ltd (NCDEX)<sup>58</sup> and the National Multi-*

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<sup>58</sup> The National Commodity and Derivatives Exchange Limited (NCDEX), url: <http://www.ncdex.com/Index.aspx> accessed on the 3rd of June of June, 2016 is a public limited company and a commodities exchange registered on the 23<sup>rd</sup> of April, 2003 under the Companies Act, 1956 (Source : <http://www.ncdex.com/CustomerServices/faqpop.htm#m04> accessed on the 3<sup>rd</sup> of June, 2016). The exchange has its registered office in Mumbai and branch offices scattered all over India Indore, Delhi, Kolkata, Hyderabad, Ahmedabad and Jaipur etc. (Source : <http://www.ncdex.com/Footer/ContactUs.aspx> accessed on the 3rd of June, 2016) .

*Commodity Exchange of India Ltd (NMCE)*<sup>59</sup> offered forward trading facilities in various commodities until the same has been banned by SEBI recently through a press release dated 15<sup>th</sup> of Jan 2016<sup>60</sup>. While NMCE had recently launched forward contracts in rubber, NCDEX has a basket of 27 commodities for forward trades.

According to the researcher, with the kind of resources it has, it will be relatively easy for Sebi (compared to FMC) to monitor forward trading. But SEBI should look at forward trading with better regulatory framework that provides for complete counter-party risk guarantee that is a given for any exchange-traded product.

## Post Trade Operations

### Background:

Until before the year 1995 the stock exchanges in India used to follow the **account period settlement system**<sup>61</sup> for settling all the trades in the stock market. Account period in the National Stock Exchange was from Wednesday to the following Tuesday. This means trades done on Wednesday, Thursday, Friday, Monday and Tuesday will be paid-in on Tuesday and paid-out on the following Wednesday. This was a time consuming process. An investor who had bought the shares will have to wait till the following Wednesday to get the delivery of shares, so he will be

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<sup>59</sup> The National Multi-Commodity Exchange of India Limited (NMCE) [url : <http://www.nmce.com/default.aspx> accessed on the 3rd of June, 2016] has been formed and promoted by the commodity related public institutions in India viz. National Agricultural Cooperative Marketing Federation of India (NAFED), Central Warehousing Corporation (CWC), Gujarat State Agricultural Marketing Board (GSAMB), Gujarat Agro-Industries Corporation Limited (GAICL), Neptune Overseas Limited (NOL) and National Institute of Agricultural Marketing (NIAM) (Source: <http://www.nmce.com/aboutus.aspx> accessed on the 3rd of June, 2016 ).

<sup>60</sup> Supra FN 53

<sup>61</sup> *Introducing and Understanding Transaction Cycle*, a copy of the document in digital form is also available at [http://cbse.nic.in/fmm-12/FMM%20II\\_Chapter%205.pdf](http://cbse.nic.in/fmm-12/FMM%20II_Chapter%205.pdf) accessed on the 5<sup>th</sup> of June, 2016

unable to reap the benefit of rising prices during the period.<sup>62</sup> Also, the shares being in physical form created a lot of problem for the buyer as they had to be sent to the company or their R&TA (Registrar & Transfer Agent) for getting the ownership changed of the securities.<sup>63</sup> While on BSE, the cycle commenced on Monday and ended on Friday. At the end of this period, the net obligations of all the brokers were calculated and the brokers settle their respective obligations as per the rules, bye-laws and regulations of the clearing corporation.

**Account period** is a system that encourages liquidity in the market because people can buy and sell without having an obligation to pay immediately - almost like using a credit card. But the flip side of the system is that the longer it takes between a trade (a buy or sell) and actual settlement, the riskier the system is. At present the scenario has changed considerably and the clearing and settlement system has become relatively more transparent.

The use of computers and electronic processes to carry out the trades and to maintain their records has made the market operations more transparent and clear. Apart from the state of art information technology, the **latest innovations**<sup>64</sup> include:

1. Emergence of clearing corporation to assume counterparty risks;
2. Replacement of account period settlement by rolling settlement system leading to shorter settlement cycles;
3. Dematerialization of securities has been adopted in place of physical securities;
4. Electronic transfer of securities through book entry system;
5. Fine tune risk management system, etc.;

Though many of these have not been implemented fully as they are yet to reach the masses and penetrate the whole market.

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<sup>62</sup> Ibid

<sup>63</sup> Ibid

<sup>64</sup> Supra FN 59



One of the greatest achievements of the current system is settlement of trades within three working days, i.e. **T+2 rolling settlement** which has replaced account period settlement, which used to take at least a week to define the obligations. Rolling settlement has now been introduced for all securities.

Rolling settlement involves shrinking the netting period to one day. This is part of the historical progression that is followed in India's equity market. The length of the netting period has gone from an undisciplined fortnight to a disciplined week, and with rolling period it now goes to about a day.

The following steps are followed in completing a transaction cycle:

**Step 1:** The transaction cycle is initiated by a securities trader who wants to either buy or sell securities. In this case, he has to take a decision regarding the same. A decision is taken by the client<sup>65</sup> after considering the liquidity conditions and requirements or reshuffles his holdings in response to changes in the market conditions or perceptions.

**Step 2:** He then selects a broker and instructs him to place buy/sell order on an exchange.

**Step 3:** The order is converted to a trade as soon as it finds a matching sell/buy order.

**Step 4:** The trades are netted to determine the obligations of the trading members to deliver securities/funds as per settlement schedule.

**Step 5:** Buyer/seller delivers funds/securities and receives securities/funds and

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<sup>65</sup> Clause 8 of the bye-law promulgated by the National Securities Clearing Corporation Limited (NSCCL) and Clause 1.7 of the bye-law promulgated by the Indian Clearing Corporation Limited (ICCL) provides almost similar definitions to the term 'client'. Client has been used interchangeably with the term 'constituent' in the bye-laws. A copy of the bye-law of NSCCL is also uploaded and made available for reference in digital form at [https://nseindia.com/content/press/nsccl\\_byelaws.pdf](https://nseindia.com/content/press/nsccl_byelaws.pdf) accessed on the 9th of June, 2016. A copy of the bye-law of the ICCL is uploaded and is made available in digital form for due reference at [http://www.icclindia.com/downloads/ICCL\\_Byelaws.pdf](http://www.icclindia.com/downloads/ICCL_Byelaws.pdf) accessed on the 9th of June, 2016.

acquires ownership of the securities.

### Post Trade Mechanism

Post-Trade division of a stock exchange focuses on the creation of a strong and committed post-trading process for securities transactions on the stock exchange. The division's work covers the operational, legal, tax, and regulatory aspects of post trading. **Post-Trade division provides clearing, settlement and custody solutions to reduce costs and risks of market participants.**<sup>66</sup>

The below figure shows that the post-trade processes are nothing but the processes involving the discharging of obligations entered into by the parties at trading level :



Source: Association for Financial Markets in Europe (AFME)<sup>67</sup>

Post-trade services are provided by the financial market infrastructural institutions such as Central Counterparties (CCPs) Clearing Houses/ Corporations and the Depositories, as well as by intermediating banks (including custodians) and brokers. Consequently as a result of the need for governance and regulation of all these processes and institutions involved in the clearing and settlement mechanisms, the market infrastructure institutions assume considerable significance.

The transaction in secondary market passes through three distinct phases, viz., **trading, clearing and settlement**. *Trading basically deals with putting an order and its execution. Clearing deals with determination of obligations, in terms of funds and securities. Settlement means that the trade will be completed and the clearing corporation acts as a counter party and takes an obligation for the same.*

<sup>66</sup> The Association for Financial Markets in Europe's (AFME) research article titled 'Post-trade Explained'. A copy of the research article is published and is also available at [www.afme.eu/WorkArea/DownloadAsset.aspx?id=12408](http://www.afme.eu/WorkArea/DownloadAsset.aspx?id=12408) accessed on the 5<sup>th</sup> of June, 2016.

<sup>67</sup> Ibid

## Trading

Trading is the activity of buying and selling securities or other financial instruments.<sup>68</sup>

## Clearing

After the trading in securities is completed on a stock exchange, the same is followed by the process of clearing. Clearing is the process of managing the actions between trade date and settlement date. Clearing can be done formally through a central counterparty (i.e. a CCP) clearing house, or informally directly between buyer and seller. CCP clearing is the process whereby the CCP becomes the buyer to any seller and the seller to any buyer, so the counterparty risk is transferred to the CCP from the actual parties to the trade.<sup>69</sup>

## Settlement

There are basically three tasks that are performed in the process of buying and selling of securities.

They are:

Trading

Clearing

Settlement

The aforementioned systems and the set of processes such as maintaining reasonable transparency in trading activity, backed by a vigilant clearing and settlement process, create and restore confidence of the common investors with regard to the point that all trades executed on the exchange would be settled and in no case any investor will have to face any problem arising out of the insufficiency of funds or securities, as the settlement of the trade on the stock exchange is guaranteed. The clearing corporation acts as a buyer to every seller and a seller to every buyer. This principle is called **novation**. *Regulation 2(1)(K) of the Securities Contracts (Regulation) (Stock Exchange and Clearing Corporations) Regulations, 2012* defines the term 'novation' as the act of a clearing corporation interposing itself between both parties of every trade, being the legal

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<sup>68</sup>Supra FN 65

<sup>69</sup> Supra FN 65

counterparty to both<sup>70</sup>. In case of default by any party, the clearing corporation takes action against the defaulter.

The following **steps** are followed in the settlement of a trade:

**Step 1: Determination of obligations:** Obligations are determined by the clearing corporation for the traders and the clearing corporation acts as a central counter-party (CCP) to the members. It determines the obligations of the members as what they ought to give or receive on the due date.

**Step 2: Pay-in of funds and securities:** The members, after knowing their obligations, make available the funds and securities to the clearing corporation. The member's depository having obligation to pay-in the securities; get an instruction from the clearing corporation to pass the required entry for the transfer of securities to them. For the members having an obligation to pay-in funds, NSCCL gives an instruction to the clearing banks for the same.

**Step 3: Pay-out of funds and securities:** After processing the shortages of funds and securities and arranging for the movement of the same, clearing corporation sends out electronic instructions to the clearing banks/ depositories to pass the required entries for the same.

**Step 4: Risk management:** Since there is a time lag between execution of trade and its settlement, there are chances of default. To minimize the risk of defaults, NSCCL has framed a comprehensive risk management and surveillance system. Under this, the organization keeps a check through various systems (on-line and off-line monitoring) and in case of default panelizes the respective trader for the same.

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<sup>70</sup> Regulation 2(1)(k) of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 defines the term 'novation'. A copy of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1340272091708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1340272091708.pdf) accessed on the 6th of June, 2016.



Settlement is the step in the post-trade process flow where the buyer receives the purchased securities and the seller receives the corresponding cash for those securities. Banks and brokers, as investors' intermediaries, are involved in the process of settling trades of securities.

*While the stock exchanges provide a platform for trading, the clearing corporations determine the funds and securities obligations of the trading members and ensure that the trade is settled through exchange of obligations.* The clearing banks and the depositories provide the necessary interface between the custodians/clearing members for settlement of funds and securities obligations of trading members.

*Several entities, like the clearing corporation, clearing members, custodians, clearing banks, depositories are involved in the process of clearing. The role of each of these entities is explained below:*

**a. Clearing Corporation:** The clearing corporation is responsible for post-trade activities such as risk management and clearing and settlement of trades executed on a stock exchange. *A clearing corporation has been defined by the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012. According to the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 a "clearing corporation" means an entity which is established to undertake the activity of clearing and settlement of trades in securities or other instruments or products that are dealt with or traded on a recognized stock exchange<sup>71</sup> and includes a clearing house.<sup>72</sup>* A recognised clearing corporation means a clearing corporation that has obtained due recognition from the SEBI under section 4 read with section 8A of the Securities Contracts (Regulation) Act, 1956.<sup>73</sup> The first clearing corporation to be established in India and also the first clearing corporation in the country to introduce settlement guarantee in India is the National Securities Clearing Corporation Ltd.

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<sup>71</sup> Regulation 2(1)(o) of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 defines the term 'recognised stock exchange' in India. A copy of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1340272091708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1340272091708.pdf) accessed on the 6th of June, 2016.

<sup>72</sup> Regulation 2(1)(d) of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 defines the term 'clearing corporation'. A copy of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1340272091708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1340272091708.pdf) accessed on the 6th of June, 2016

<sup>73</sup> Supra FN 64

(NSCCL), which is a wholly owned subsidiary of the National Stock Exchange of India Limited (NSEIL).<sup>74</sup> NSCCL has been incorporated in the month of August 1995 with its registered office located in Mumbai, India. The NSCCL commenced its clearing operations in the month of April, 1996.<sup>75</sup> However, another important clearing corporation of India is the Indian Clearing Corporation Limited i.e. ICCL which has been incorporated in the year 2007 as a wholly owned subsidiary of BSE Ltd ("BSE").<sup>76</sup> ICCL carries out the functions of clearing, collateral management, settlement, and risk management for various segments of the Bombay Stock Exchange.<sup>77</sup> ICCL undertakes to act as the central counterparty to all the trades executed on the BSE platform and provides the clearing and settlement services for the same.<sup>78</sup> The clearing corporations were set up with the objectives of bringing and sustaining confidence in clearing and settlement of securities; promoting and maintaining short and consistent settlement cycles; providing counter-party risk guarantee, and operating a tight risk containment system.<sup>79</sup>

**b. Clearing Members:** A clearing member is a member attached to a clearing corporation and who is also in possession of the clearing and settlement rights in any clearing corporation recognised by the SEBI.<sup>80</sup> A clearing member may also be a juridical person and it is not necessary that the clearing member has to be an individual. This is because of the reason that the definition provided by the regulation 2(1)(e) of the Securities Contracts (Regulation)(Stock Exchange and Clearing Corporations) Regulations, 2012 uses the term 'person' while defining the term 'clearing

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<sup>74</sup> The National Securities Clearing Corporation Limited (NSCCL) is the first clearing corporation established to clear and settle trades executed on the National Stock Exchange of India Limited (NSEIL) platform by its trading members and their clients. The NSCCL also claims to be the first clearing corporation in the country to provide guarantee to the participants on the NSEIL platform. This information is made available on the official website of the NSCCL under the heading, *NSCCL, The Organisation*, refer to the web link available at [http://www.nscclindia.com/NSCCL/about\\_nsccl.htm](http://www.nscclindia.com/NSCCL/about_nsccl.htm) accessed on the 5th of June 2016.

<sup>75</sup> Refer to the web link [http://www.nscclindia.com/NSCCL/about\\_nsccl.htm](http://www.nscclindia.com/NSCCL/about_nsccl.htm) accessed on the 5th of June, 2016

<sup>76</sup> Refer to the media release by the ICCL dated the 18<sup>th</sup> of Nov. 2014. A copy of the said media release by the Indian Clearing Corporation Limited (ICCL) is also available at [http://www.icclindia.com/downloads/ICCL\\_becomes\\_the\\_first\\_entity\\_to\\_be\\_assignedLEI\\_by\\_CCIL.pdf](http://www.icclindia.com/downloads/ICCL_becomes_the_first_entity_to_be_assignedLEI_by_CCIL.pdf) accessed on the 5th of June, 2016

<sup>77</sup> Refer to the web page providing the company profile of the Indian Clearing Corporation Limited (ICCL) available at <http://www.icclindia.com/static/about/companyprofile.aspx> accessed on the 6th of June, 2016

<sup>78</sup> Supra 70

<sup>79</sup> Supra FN 69

<sup>80</sup> Regulation 2(1)(e) of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 defines the term 'clearing member'. A copy of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1340272091708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1340272091708.pdf) accessed on the 6th of June, 2016.

corporation'.<sup>81</sup> The clearing members are responsible for settling their obligations as determined by the clearing corporation. They do so by making available funds and/or securities in the designated accounts maintained with the clearing bank/ depositories on the date of settlement.

**c. Custodians:** Custodians are the financial institutions registered with SEBI and are permitted by the market regulator to provide custodial services to various market participants. They are regulated by the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996.<sup>82</sup> According to Regulation 2(d) of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 '*custodian of securities*' means *any person who carries on or proposes to carry on the business of providing custodial services*.<sup>83</sup> Regulation 2(e) of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 defines and enumerates as to what constitutes 'custodial services'.<sup>84</sup> According to the regulation 2(e) of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 custodial service means safekeeping of the securities or other such instruments and also providing services incidental to the same.<sup>85</sup> Thus custodial services provided by the custodian of securities may include maintaining accounts of securities etc., collecting the benefits or rights accruing to the client<sup>86</sup> in respect of securities etc., undertaking activities as a Domestic Depository in terms of the Companies (Issue of Indian Depository Receipts) Rules, 2004, maintaining and reconciling records of the services and keeping the client informed of the actions taken or to be taken by the issuer of securities, having a bearing on the benefits or rights accruing to the client etc.<sup>87</sup>

Custodians are clearing members but not trading members. They settle trades on behalf of trading members, when a particular trade is assigned to them for settlement. The custodian is required to confirm whether he is going to settle that trade or not. If he confirms to settle that trade, then

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<sup>81</sup> Ibid

<sup>82</sup> Regulation 2(d) of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 defines the term 'custodian of securities'. A copy of the regulations the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 is also available in digital form at <http://www.sebi.gov.in/acts/act05a.pdf> accessed on the 6th of June, 2016

<sup>83</sup> Ibid

<sup>84</sup> Regulation 2(e) of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 defines the term 'custodial services'. A copy of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 is also available in digital form at <http://www.sebi.gov.in/acts/act05a.pdf> accessed on the 6th of June, 2016

<sup>85</sup> Ibid

<sup>86</sup> Supra FN 63

<sup>87</sup> Ibid

clearing corporation assigns that particular obligation to him. If the custodian confirms the trade, the clearing corporation assigns the obligation to the custodian. If the custodian rejects the trade, the obligation is assigned back to the trading member. Regulation 17<sup>88</sup> of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996, provides that every custodian of securities mandatorily enters into an agreement with each of its client<sup>89</sup> on whose behalf custodian is acting as the custodian of securities and every such agreement mandatorily provides for and enumerates the circumstances under which the custodian of securities will accept or release securities, assets or documents from the custody account; the circumstances under which the custodian of securities will accept or release monies from the custody account; the circumstances under which the custodian of securities will receive rights or entitlements on the securities of the client etc.<sup>90</sup>

At present, the clearing corporation associated with the National Stock Exchange of India Limited (NSEIL) i.e. NSCCL has 13 empanelled custodians.<sup>91</sup> These details have been made available at the official website of NSEIL.<sup>92</sup> Likewise, the ICCL has a total of 17 empanelled custodians.<sup>93</sup>

The Custodians' Clearing members are required to request Clearing Corporation for allotment of Custodian Participant (CP) code for the clients<sup>94</sup> for which they wish to clear and settle.<sup>95</sup> The request has to be made along-with documentation for the said purpose like SEBI registration number, PAN number etc. depending on the category of the client.<sup>96</sup>

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<sup>88</sup> Regulation 17 of the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 provides broad terms of agreement between the custodian of securities with its clients. . A copy of the regulations the Securities and Exchange Board of India (Custodian of Securities) Regulation 1996 is also available in digital form at <http://www.sebi.gov.in/acts/act05a.pdf> accessed on the 6th of June, 2016

<sup>89</sup> Supra FN 63

<sup>90</sup> Ibid

<sup>91</sup> Refer to the official website of the National Stock Exchange of India Limited (NSEIL). The information about the financial institutions that provide custodial services to the NSCCL is available in digital form at [https://www.nseindia.com/supra\\_global/content/nsccl/custodians.htm](https://www.nseindia.com/supra_global/content/nsccl/custodians.htm) accessed on the 6th of June, 2016

<sup>92</sup> Ibid

<sup>93</sup> The names and other details of the custodians to the ICCL is also available at [http://www.icclindia.com/downloads/ICCL\\_List\\_of\\_Custodians.pdf](http://www.icclindia.com/downloads/ICCL_List_of_Custodians.pdf) accessed on the 6th of June, 2016

<sup>94</sup> Supra FN 63

<sup>95</sup> Refer to the website of the National Stock Exchange of India Limited (NSEIL). The information is available at [https://www.nseindia.com/supra\\_global/content/nsccl/custodians.htm](https://www.nseindia.com/supra_global/content/nsccl/custodians.htm) accessed on the 6th of June, 2016

<sup>96</sup> Supra FN 81



**d. Clearing Banks:** Clearing banks are a key link between the clearing members and Clearing Corporation to effect settlement of funds. Clearing banks are regulated by the Reserve Bank of India.<sup>97</sup> According to the bye-laws of the National Securities Clearing Corporation Limited (NSCCL), *a Clearing Bank(s) is such a bank(s) as the Clearing Corporation may appoint to act as a funds settling agency, for the collection of margin money for all deals cleared through the Clearing Corporation and any other funds movement between clearing members and the Clearing Corporation and between clearing members as may be directed by the Clearing Corporation from time to time.*<sup>98</sup> Almost a similar definition has been provided to the term ‘clearing banks’ by the bye-laws of the Indian Clearing Corporation Limited (ICCL).<sup>99</sup> Some of the basic services provided by the clearing banks associated with the NSCCL are stock lending facilities, providing funds for working capital, services of the depositories participants and various other capital market related services/facilities etc.<sup>100</sup> According to regulation 7(4)(f) of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations 2012 along with depositories and other market infrastructure institutions and intermediaries like the stock exchanges and clearing members, a clearing corporation must establish connectivity with clearing banks in order to function like a clearing corporation.<sup>101</sup> Every clearing member<sup>102</sup> is required to

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<sup>97</sup> The Reserve Bank of India is the regulator of banking organizations in India; url:

<https://www.rbi.org.in/home.aspx> accessed on the 7th of June, 2016.

<sup>98</sup> Clause 5 of the National Securities Clearing Corporation Limited (NSCCL) bye-law defines the ‘clearing bank’. Clearing Corporations attached to the stock exchanges have their own bye-laws (approved by the SEBI) to regulate themselves and other market participants. These bye-laws instills market discipline. A copy of the bye-law published by the National Securities Clearing Corporation Limited (NSCCL) is also uploaded and made available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMbyelaws.pdf> accessed on the 9th of June, 2016

<sup>99</sup> Clause 1.3 of the bye-law enacted by the Indian Clearing Corporation Limited (ICCL) defines the term ‘clearing banks’. A copy of the bye-law enacted by the ICCL has been uploaded and made available in digital form at [http://www.icclindia.com/downloads/ICCL\\_Byelaws.pdf](http://www.icclindia.com/downloads/ICCL_Byelaws.pdf) accessed on the 9th of June, 2016

<sup>100</sup> Some of the essential services provided by the associated clearing banks to the National Securities Clearing Corporation Limited (NSCCL) are enlisted and made available for information of public at large at [https://www.nseindia.com/supra\\_global/content/nscl/clearing\\_banks.htm](https://www.nseindia.com/supra_global/content/nscl/clearing_banks.htm) accessed on the 9th of June, 2016.

<sup>101</sup> Regulation 7(4)(f) of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 lays down the precondition for clearing corporations to mandatorily connect with clearing banks in order to execute their responsibilities/ functions as a clearing corporations attached with stock exchanges in India. A copy of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1340272091708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1340272091708.pdf) accessed on the 9th of June, 2016.

<sup>102</sup> Regulation 2(1)(e) of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 defines the term ‘clearing member’ as a person having clearing and settlement rights in any recognise clearing corporations. A copy of the Securities Contracts (Regulation)(Stock Exchanges and Clearing Corporations) Regulations, 2012 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1340272091708.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1340272091708.pdf) accessed on the 9th of June, 2016.

open a dedicated clearing account with one of the designated clearing banks. Every Clearing Member is required to maintain and operate clearing accounts with the empanelled<sup>103</sup> clearing banks at the designated clearing bank branches.<sup>104</sup> Every Clearing Member is also required to maintain and operate a primary clearing account with any one of the empanelled clearing banks at the designated clearing bank branches.<sup>105</sup> ***The primary clearing account is to be used exclusively for clearing operations i.e., for settling funds and other obligations to the Clearing Corporation including payments of margins and penal charges.***<sup>106</sup> According to regulation 13.3<sup>107</sup> of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 every clearing member is required to maintain a clearing account with the designated clearing bank or any of its branch which is to be exclusively used only for the purposes like settlement of deals and payment of margin money etc. The clearing member is prohibited from using the said clearing account for any other purpose unless the same is specified by the relevant authority.<sup>108</sup> The term ‘relevant authority’<sup>109</sup> has been defined to mean the Board,<sup>110</sup> the Securities and Exchange Board of India

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<sup>103</sup> The National Securities Clearing Corporation Limited (NSCCL) has 13 empanelled banks associated with it and is offering clearing and related services to the trades executed on the NSE. The details of the clearing banks associated with NSCCL is also available at

[https://www.nseindia.com/supra\\_global/content/nsccl/clearing\\_banks.htm](https://www.nseindia.com/supra_global/content/nsccl/clearing_banks.htm) accessed on the 9th of June, 2016

<sup>104</sup> According to the mechanism put in place by the National Securities Clearing Corporation Limited (NSCCL) clearing members operating esp. in the derivatives segment of the National Stock Exchange of India Limited (NSEIL) are required to maintain a primary clearing account with the designated clearing banks associated with the NSCCL. The information is made available at

[https://www.nseindia.com/products/content/derivatives/equities/clearing\\_bank.htm](https://www.nseindia.com/products/content/derivatives/equities/clearing_bank.htm) accessed on the 9th of June, 2016.

<sup>105</sup> Supra FN 99

<sup>106</sup> Ibid

<sup>107</sup> The National Securities Clearing Corporation Regulations (Capital Market Segment) or the National Securities Clearing Corporation (Capital Market) Regulations, 1996 are applicable to the various participants of the National Securities Clearing Corporation Limited (NSCCL). A copy of the National Securities Clearing Corporation Regulations (Capital Market Segment) have promulgated by the National Securities Clearing Corporation Limited (NSCCL) and has been uploaded and made available in digital form at

<https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> accessed on 13th of June, 2016

<sup>108</sup> Regulation 13.3 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 National Securities Clearing Corporation Regulations (Capital Market Segment) provides that the clearing member is prohibited from using the clearing account for other purposes except for the purpose of clearing unless the same is specified by relevant authority.

<sup>109</sup> Refer to rule 9 of the National Securities Clearing Corporation Rules and Rule 1(O) of the Indian Clearing Corporation limited Rules respectively for definition of the term ‘relevant authority’. A copy of the National Securities Clearing Corporation Rules is available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMrules.pdf> accessed on the 15th of June, 2016 and a copy of the Indian Clearing Corporation limited Rules is also available in digital form at [http://www.icclindia.com/downloads/ICCL\\_Rules.pdf](http://www.icclindia.com/downloads/ICCL_Rules.pdf) accessed on the 15th of June, 2016.

<sup>110</sup> According to clause 2 of the National Securities Clearing Corporation Limited (NSCCL) bye-laws the ‘Board’ means the Board of Directors of the National Securities Clearing Corporation Limited (NSCCL). A copy of the

(SEBI) or such other authority which may be specified by the Board from time to time as relevant for a specified purpose according to clause 15 of the National Securities Clearing Corporation Limited (NSCCL) bye-laws.<sup>111</sup> A Clearing member having funds obligation to pay ensures the availability of sufficient clear balance in the clearing account on or before the stipulated funds pay-in day and the stipulated time.<sup>112</sup> According to regulation 6.13 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996, a Capital Market clearing member i.e. a CM clearing member is required to mandatorily maintain sufficient clear balance of funds in his clearing account to the extent of funds that is to be debited from his account and on the pay-in day the Clearing Bank(s) debits a CM clearing member's clearing account to the extent of his funds obligation as per the instructions of the Clearing Corporation.<sup>113</sup> Further according to regulation 13.4 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996, a clearing bank is mandated to debit or credit funds from the clearing account of the clearing member who is attached to the National Securities Clearing Corporation Limited (NSCCL) strictly according to instructions of the clearing corporation i.e. the National Securities Clearing Corporation Limited (NSCCL) in case of trades executed on NSE.<sup>114</sup> Regulation 6.12 of the Indian Clearing Corporation Limited Regulations<sup>115</sup> and *Regulation 6.13 of the National Securities*

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National Securities Clearing Corporation Limited (NSCCL) bye-laws is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMbyelaws.pdf> accessed on the 13th of June, 2016

<sup>111</sup> Clause 15 of the National Securities Clearing Corporation Limited (NSCCL) bye-laws defines the term 'relevant authority'. A copy of the National Securities Clearing Corporation Limited (NSCCL) bye-laws is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMbyelaws.pdf> accessed on the 13th of June, 2016

<sup>112</sup> Regulation 6.13 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 prescribes that the CM clearing member of the NSCCL must maintain a clear balance of funds to be debited from the CM Clearing member's fund maintained with his clearing account. The debit/credit amount is debited or credited as per the instructions of the clearing corporation i.e. the National Securities Clearing Corporation Limited (NSCCL). A copy of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> accessed on the 13th of June, 2016.

<sup>113</sup> Ibid

<sup>114</sup> Regulation 13.4 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 provides that the clearing bank is mandated to act strictly as per the instructions of the clearing corporation i.e. NSCCL (in this case) and shall accordingly debit or credit the clearing accounts of the clearing members as per the instruction(s) received by the clearing bank from the clearing corporation. A copy of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> accessed on the 15th of June, 2016

<sup>115</sup> Regulation 6.12 of the Indian Clearing Corporation Limited (ICCL) Regulations provides that every clearing member has to ensure that sufficient balance of funds in his clearing account is present for the ultimate settlement of trades/ deals executed by the client/ constituent of the clearing member or to which the concerned member is a party. A copy of the ICCL Regulations in digital form is also available at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> accessed on the 15<sup>th</sup> of June, 2016



*Clearing Corporation (Capital Market) Regulations, 1996* provides that the clearing members are required to maintain sufficient balance of funds in their clearing accounts. Further, every clearing member is allowed to maintain and operate additional clearing accounts exclusively for the purpose of enhancement of collaterals. All the credits and debits other than collateral enhancement specified by the member are mandatory routed through the primary clearing account.

*Clearing Members are required to authorise the Clearing Bank to access their clearing accounts for debiting and crediting their accounts, reporting of balances and other information as may be required by NSCCL from time to time<sup>116</sup> as per the specified format.<sup>117</sup>* Also the board of directors of the National Securities Clearing Corporation Limited, the board of directors of the Indian Clearing Corporation Limited, the SEBI or any other relevant authority,<sup>118</sup> as the case may be, has the right and authority to withhold the payment of securities or funds as the case may be to the clearing member on the pay-out day.<sup>119</sup> Regulation 9.9 read with regulation 6.15 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and regulation 9.9 read with regulation 6.14 of the Indian Clearing Corporation Limited i.e. ICCL Regulations deal with the issue of 'withholding of funds or securities' for the purposes of settlement of dues of the clearing members.<sup>120</sup> The Clearing Bank may debit or credit the clearing account of the clearing member as per instructions received from the Clearing Corporation.<sup>121</sup> According to the regulation 13.4 of

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<sup>116</sup> Refer to regulation 13.6 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and also refer regulation 13.6 of the Indian Clearing Corporation Limited i.e. ICCL Regulations respectively. A copy of the ICCL Regulations in digital form is also available at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> and also at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> respectively accessed on the 15<sup>th</sup> of June, 2016.

<sup>117</sup> Supra FN 93

<sup>118</sup> Supra FN 104

<sup>119</sup> Regulation 9.9 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 as well as regulation 9.9 of the Indian Clearing Corporation Limited authorizes the NSCCL and ICCL respectively to withhold pay-out of securities /funds to the clearing member under certain circumstances, stipulated in regulation 9.9 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and the Indian Clearing Corporation Limited i.e. ICCL Regulations, read with the regulation 6.15 and regulation 6.14 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and the Indian Clearing Corporation Limited i.e. ICCL Regulations respectively. A copy of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> accessed on the 15<sup>th</sup> of June, 2016. A copy of the ICCL Regulations in digital form is also available at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> accessed on the 15<sup>th</sup> of June, 2016.

<sup>120</sup> Ibid

<sup>121</sup> Refer to regulation 13.4 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and also refer to regulation 13.4 of the Indian Clearing Corporation Limited i.e. ICCL Regulations respectively. A copy of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and also the ICCL Regulations, in digital form is also available at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> and <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> respectively accessed on the 15<sup>th</sup> of June, 2016.

the National Securities Clearing Corporation (Capital Market) Regulations, 1996, the clearing bank has to mandatorily act (i.e. debit or credit the clearing account of the clearing member) strictly as per the instructions received by it from the clearing corporation so far as funds movement from the clearing account of the clearing member is concerned.<sup>122</sup> The instructions issued by the clearing corporation as to debit or to credit a clearing member's account is deemed to be irrevocable and is also presumed to be confirmed instructions issued by a clearing member to debit his account and/or credit the account funds as specified in the instruction.<sup>123</sup> This is because of the reason that the clearing member at the time of opening a clearing account with the clearing bank issues instructions to the clearing bank to follow the instructions of the clearing corporation while debiting or crediting the clearing account of the clearing member. The money that is held in the clearing account is held in trust by the clearing corporation on behalf of the clearing member and the clearing corporation acts like an agent for the clearing member in matters pertaining to the clearing and settlement of deals on behalf of the clearing member, through the clearing corporation.<sup>124</sup> Hence the instructions issued by the clearing corporation with regard to the handling of funds maintained with the clearing accounts are deemed to be issued by the clearing member.<sup>125</sup> The Clearing Member or any person claiming through him does not have or be legally presumed to have any right, title or interest in any monies in the Clearing Account or other account(s) of the Clearing Corporation with the Clearing Bank.<sup>126</sup>

The clearing members in order to shift their primary clearing account from one designated clearing bank to another designated clearing bank are required to abide by the following procedure:<sup>127</sup>

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<sup>122</sup> Supra FN 116

<sup>123</sup> Refer to Regulation 13.7 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996. A copy of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 is also available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> accessed on the 15th of June, 2016. Also refer to regulation 13.7 of the ICCL Regulations. A copy of the ICCL Regulations is available in digital form at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> respectively, accessed on the 15th of June, 2016.

<sup>124</sup> Ibid

<sup>125</sup> Ibid

<sup>126</sup> Refer to regulation 13.7 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and also refer to regulation 13.7 of the ICCL Regulations. A copy of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and also a copy of the ICCL Regulations is available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> and also available at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> respectively, accessed on the 15th of June, 2016.

<sup>127</sup> Supra FN 99



- The clearing member while requesting the Clearing Corporation for a change in the primary clearing bank account is required either :
  - i. Furnish the no objection certificate (NOC) received by the member from the existing primary clearing bank for shifting of account, or<sup>128</sup>
  - ii. In case no response is received by the clearing member from the existing primary clearing bank in respect of the NOC request even after a minimum waiting period of a fortnight, a declaration to the effect (i.e. change in primary clearing account) along with an acknowledged copy of the NOC request made by the member to the existing primary clearing bank.<sup>129</sup>

The Clearing Corporations thereon issue a letter of introduction to the other designated clearing bank.

On opening the account with the other designated clearing bank, the clearing member shall submit to the Clearing Corporation the account particulars issued by the bank and also the acknowledged copy of the letter issued by the clearing member to the clearing bank.<sup>130</sup>

The Clearing Corporation thereon communicates the date from which the new primary clearing account will be operational. The clearing members are thereafter required to intimate the Clearing Corporation whether they wish to continue the existing primary clearing account as one of the additional clearing accounts or discontinue the existing primary clearing account after the change in primary clearing bank.<sup>131</sup> In the event where the clearing members wish to discontinue the existing primary clearing account, the Clearing Corporation shall communicate the date after which the existing primary clearing account may be closed by the clearing member.

A Clearing member can deposit funds into his accounts in any form, but can withdraw funds from these accounts only in self-name.

A clearing member is not allowed to close or de-activate the clearing account without the prior written consent of the Clearing Corporation.

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<sup>128</sup> Supra FN 99

<sup>129</sup> The procedure has been supported by a circular issued by the National Securities Clearing Corporation Limited (NSCCL) dated 4<sup>th</sup> of June 2009. A copy of the circular is also available at <https://www.nseindia.com/content/circulars/cmpt12518.htm> accessed on the 15th of June, 2016.

<sup>130</sup> Supra FN 99

<sup>131</sup> Ibid

The clearing accounts are to be used exclusively for clearing & settlement operations.<sup>132</sup> Based on the clearing member's obligation as determined through clearing, the clearing member makes funds available in the clearing account for the pay-in and receives funds in case of a pay-out. There are 13 clearing banks associated with NSCCL<sup>133</sup> and around 20 clearing banks associated with the ICCL.<sup>134</sup>

**e. Depositories:** In the depository system, securities are held in depository accounts. The process is more or less similar to holding funds in bank accounts. Transfer of ownership of securities is relatively easy, faster and smoother as the same is done through the process of simple account transfers through the online platforms. This method does away and avoids all the risks and hassles normally associated with paperwork. Consequently, the cost of transacting in a depository environment is considerably lower as compared to transacting in certificates of shares and other securities. A depository holds securities in dematerialized form on behalf of the investor in his beneficiary account. An investor is also known as the beneficial owner (BO) under the depository/demats system. Under the depository/demat system the investor or the beneficial owner is required to open a demat account through any Depository Participant or DP for dematerialization of his holdings and transferring securities. A Depository Participant is an agent of the Depository. *It is the duty of the depository participant<sup>135</sup> to allow the beneficial owner of the securities, the right to flexibly withdraw or transfer securities from his demat account in accordance with the procedure laid down in the agreement<sup>136</sup> between the depository participant and the beneficial*

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<sup>132</sup> Regulation 13.3 of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and regulation 13.3 of the ICCL Regulations prohibits a clearing member from using his funds available in the clearing account for any other purpose other than clearing and settlement of trades/deals executed on the exchange. A copy of the National Securities Clearing Corporation (Capital Market) Regulations, 1996 and the ICCL Regulations are available in digital form at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> and at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> accessed on the 16<sup>th</sup> of June 2016.

<sup>133</sup> The detailed information about the clearing banks, their name and contact persons associated with the National Securities Clearing Corporation Limited is available in digital form at [http://www.nscclindia.com/NSCCL/partners/nsccl\\_partner\\_clr\\_bank.htm](http://www.nscclindia.com/NSCCL/partners/nsccl_partner_clr_bank.htm) accessed on the 7<sup>th</sup> of June, 2016.

<sup>134</sup> The detailed information about the clearing banks associated with the Indian Clearing Corporation Limited (ICCL) is also available in digital form at <http://www.icclindia.com/downloads/ListofDesignatedClearingBanksinICCL.pdf> accessed on the 7<sup>th</sup> of June, 2016.

<sup>135</sup> Regulation 19 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 prescribes the criteria to be fulfilled by a depository participant for the registration of the 'depository participant' as such. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRregulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRregulations.pdf) accessed on the 19<sup>th</sup> of June, 2016.

<sup>136</sup> Regulation 41 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 prescribes that every depository participant is required to enter into an agreement with a beneficial owner before

owner.<sup>137</sup> According to law, every depository participant is required to enter into an agreement with the beneficial owner before acting as the depository participant for him.<sup>138</sup> The depository participant is also required by law to open a separate account for each beneficial owner.<sup>139</sup> The depository participant must open and segregate the demat accounts of each and every beneficial owner in a manner so that the securities held by the beneficial owner in his demat account does not mix with the securities held by the other beneficial owners (who are maintaining a demat account with the same depository participant) or with the securities held by the depository participant in his demat account.<sup>140</sup> The depository participant is also liable to provide a statement of accounts<sup>141</sup> to the beneficial owner in prescribed manner and within the time period as may be provided in the demat account agreement.<sup>142</sup> Each clearing member is required to maintain a clearing pool account with the depositories. He is required to make available the required securities in the designated account on settlement day. **Bye-law 2 of the chapter –V of the National Securities Clearing Corporation Limited (NSCCL) Byelaws and the Byelaw 5.8 under chapter - V of the Indian Clearing Corporation Limited Byelaws** prescribes that a clearing member of any segment may clear and settle deals through clearing corporation pertinent to that segment strictly following the manner, mode, terms and conditions, procedures laid down etc. by the clearing

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acting as a depository participant on the beneficial owner's behalf. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRRegulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRRegulations.pdf) accessed on the 19th of June, 2016

<sup>137</sup> Regulation 44 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 deals with and regulates the transfer or withdrawal by beneficial owner. Regulation 44 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 imposes a duty upon the depository participant to allow the beneficial owner a free transfer or withdrawal from his account. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRRegulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRRegulations.pdf) accessed on the 19th of June, 2016.

<sup>138</sup> Supra FN 131

<sup>139</sup> Regulation 42 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 deals with the segregation of demat accounts of the beneficial owners. Regulation 42 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 calls for complete segregation and creation of the separate individual demat account for each beneficial owner by the depository participant. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRRegulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRRegulations.pdf) accessed on the 19th of June, 2016.

<sup>140</sup> Ibid

<sup>141</sup> Regulation 43 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 mandates that every depository participant must provide a statement of account to the beneficial owner within such time as provided in the agreement between depository participant and the beneficial owner. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 in digital form is also available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRRegulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRRegulations.pdf) accessed on the 19th of June, 2016.

<sup>142</sup> Supra FN 131

corporation and as specified for the said clearing member.<sup>143</sup> *Byelaw 17 under chapter-VI of the National Securities Clearing Corporation Limited (NSCCL) Byelaws and Byelaw 6.18 of the Indian Clearing Corporation Limited* prescribes that if a clearing member fails to meet his obligations to the Clearing Corporation that arises out of the clearing and settlement operations of admitted deals, the board of directors of the NSCCL or such other relevant authority<sup>144</sup> as prescribed by the Byelaws, may impose such penalties and fines, charge such interest and take such other disciplinary action against the clearing member as it may determine from time to time. However, any disciplinary action which the relevant authority<sup>145</sup> takes pursuant to the clearing members' failure to meet his clearing obligations shall not affect the obligations of the said clearing member to the Clearing Corporation or any remedy to which the Clearing Corporation may be entitled under applicable law.<sup>146</sup> The depository runs an electronic file to transfer the securities from accounts of the custodians/clearing member to that of NSCCL and vice-versa as per the schedule of allocation of securities. Regulations 37 and regulation 38 of the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 deals with the types of records that a depository is required under law to mandatorily maintain and the manner in which the records in electronic form may be maintained by the depositories.<sup>147</sup> Where the records are maintained electronically by the depository, the depository is required to ensure that the integrity

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<sup>143</sup> Chapter V of the National Securities Clearing Corporation Limited Byelaws and also Chapter – V of the Indian Clearing Corporation Limited Byelaws deals with the byelaw relating to the clearing members associated with the National Securities Clearing Corporation Limited. Byelaw 2 under Chapter –V of the NSCCL Byelaws and Byelaw 5.8 under chapter- V of the ICCL prescribes that a clearing member may clear and settle deals through the clearing corporation undertaking to settle deals in that segment. A copy of the National Securities Clearing Corporation Byelaws is also available for reference at

<https://www.nseindia.com/global/content/regulations/NSCCLCMbyelaws.pdf> accessed on the 11th of July, 2016

and a copy of the Indian Clearing Corporation Limited Byelaws is also available at

[http://www.icclindia.com/downloads/ICCL\\_Byelaws.pdf](http://www.icclindia.com/downloads/ICCL_Byelaws.pdf) accessed on the 11th of July, 2016

<sup>144</sup> Supra FN 104

<sup>145</sup> Ibid

<sup>146</sup> Byelaw 17 under chapter – VI of the National Securities Clearing Corporation Limited Byelaws and Byelaw 6.18 under chapter - VI of the Indian Clearing Corporation Limited Byelaws deals with the consequences that might be faced by a clearing member when he (i.e. the clearing member) fails to meet his clearing and settlement obligations. A copy of the National Securities Clearing Corporation Limited Byelaws is also available in digital form for reference by general public at <https://www.nseindia.com/global/content/regulations/NSCCLCMbyelaws.pdf> accessed on the 11th of July 2016 and a copy of the Indian Clearing Corporation Limited Byelaws is available in digital form for reference at [http://www.icclindia.com/downloads/ICCL\\_Byelaws.pdf](http://www.icclindia.com/downloads/ICCL_Byelaws.pdf) accessed on the 11th of July, 2016

<sup>147</sup> Regulation 37 and regulation 38 of the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 is also available in digital form for reference at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRRegulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRRegulations.pdf) accessed on the 12th of July, 2016.



of the automatic data processing system is maintained at all times and the depository is also required to undertake to ensure that all precautionary measures necessary to ensure that the records are not lost, tampered with or destroyed. In the event of any loss or destruction of the electronic data maintained by the depository, the depository is required to ensure that sufficient back up of electronic records is available at all times at a different place or location.<sup>148</sup> Also a depository is mandated to furnish details of its infrastructural setup including the system of automatic data processing, backup and storage systems and procedures and communication system that it has setup or proposes to setup before commencement of business as a depository in India with the regulator i.e. SEBI.<sup>149</sup> The Securities and Exchange Board of India i.e. SEBI thoroughly scrutinizes the infrastructural setup for maintenance of electronic data system, before approving the request of an entity/body corporate/ person to act or function as a depository in India. At present there are two depositories in India, viz. the National Securities Depository Ltd (NSDL)<sup>150</sup> established in the month of August, 1996<sup>151</sup> and the other depository is the Central Depository Services (India) Ltd (CDSL)<sup>152</sup> which commenced its business in the month of February 1999.<sup>153</sup> ***The Industrial Development Bank of India i.e. IDBI, the Unit Trust of India i.e. UTI and the National Stock Exchange of India Limited i.e. NSEIL are the promoters of the National Securities Depository***

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<sup>148</sup> Regulation 37 of the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 is also available in digital form for reference at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRRegulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRRegulations.pdf) accessed on the 12th of July, 2016

<sup>149</sup> The First Schedule to the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 provides the format of application to be filled in and filed for approval with the Securities and Exchange Board of India by a proposed or a prospective Depository. Clause 11 of the First Schedule to the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 prescribes that the details of the proposed infrastructural setup for maintenance of data (including electronic data), its communication through the electronic mode and backup systems etc. must be furnished with the regulator i.e. SEBI at the time of making application to act as a depository in India. Unless the regulator i.e. the SEBI is satisfied with the actual or proposed infrastructural setup (including the setup for electronic data transfer and communication) the approval to act as a depository may not be granted to a financial entity. A copy of the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 is also available in digital form for reference at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/DPRRegulations.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/DPRRegulations.pdf) accessed on the 12th of July, 2016

<sup>150</sup> The National Securities Depository Limited was established by the some reputed banking and financial institutions in India in the year 1996 to facilitate the dematerialized holding of securities issued by the issuer companies in India. More information about the NSDL as an institution is available at the official website of the NSDL, url: <https://nsdl.co.in/index.php> accessed on the 12th of July, 2016

<sup>151</sup> Refer to the official website of the National Securities Depository Limited (NSDL) at <https://nsdl.co.in/about/index.php> accessed on the 12th of July, 2016

<sup>152</sup> More information about the Central Depository Services Limited (CDSL) refer to the official website of the CDSL. url : <https://www.cdslindia.com/index.html> accessed on the 12th of July 2016.

<sup>153</sup> Refer to the official website of the Central Depository Services Limited (CDSL) at <https://www.cdslindia.com/aboutcdsl/introduction.html> accessed on the 12th July, 2016



*Ltd (NSDL).*<sup>154</sup> Some of the reputed banking institutions in India also have a stake in the NSDL and they are the State bank of India, Axis Bank Limited, HDFC Bank limited, Union Bank of India, the Deutsche Bank, Dena Bank etc.<sup>155</sup> The Bombay Stock Exchange Limited in association with the Bank of India, Bank of Baroda, the State Bank of India and the HDFC Bank are the promoters of the Central Depository Services Limited.<sup>156</sup> The other shareholders of the Central Depository Services Limited (i.e. CDSL) are the Canara Bank, the Bank of Maharashtra, the Union Bank of India, the Calcutta Stock Exchange etc.<sup>157</sup>

**f. Professional Clearing Member:** According to the SEBI Committee on Derivatives Trading in India while suggesting the model bye-laws which may be followed and enacted by the clearing houses or clearing corporations operating in the securities market segments in India. The proposed bye-laws by the committee was recommended for regulating and controlling the trading and settlement operations pertaining to the derivative contracts traded on stock exchanges in India. According to the SEBI Committee's proposed bye-laws *a professional clearing member means a clearing member who is admitted by the clearing corporation and who may clear and settle deals either on his own account or on account of his clients or on account of the trading members of the specified Exchange(s) and/or their clients.*<sup>158</sup> The National Securities Clearing Corporation Limited (NSCCL) and the Bombay Stock Exchange Limited admits a special category of members known as professional clearing members (PCMs). PCMs may clear and settle trades executed for their clients<sup>159</sup> (individuals, institutions etc.). In such cases, the functions and responsibilities of the PCM are similar to that of the custodians. A PCM is different from a TCM i.e. a trading-cum-clearing member; because a PCM has no trading rights on an exchange whereas the TCM has both the trading and clearing rights.<sup>160</sup> A PCM only has the clearing rights unlike the TCMs who also

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<sup>154</sup> Refer to the official website of the National Securities Depository Limited(NSDL) at <https://nsdl.co.in/about/shareholder.php> accessed on the 12th of July, 2016

<sup>155</sup> Ibid

<sup>156</sup> Refer to the official website of the Central Depository Services Limited at <https://www.cdslindia.com/aboutcdsl/promoters.html> accessed on the 12th of July, 2016

<sup>157</sup> Supra FN 151

<sup>158</sup> Refer to the suggestions of the SEBI Committee on Derivatives Trading in India on model bye-laws for regulation and control of trading and settlement of derivative contracts in India available in digital form for reference at <http://www.sebi.gov.in/commreport/byelaw06.html> accessed on the 12th July, 2016.

<sup>159</sup> Supra FN 63

<sup>160</sup> Refer to the official website of the Bombay Stock Exchange Limited. The information/ explanation is also available in digital form for reference at <http://www.bseindia.com/markets/Derivatives/DeriReports/becomeamember.aspx?expandable=5> accessed on the 12<sup>th</sup> of July, 2016.

possess the trading rights on an exchange in addition to the clearing rights on the clearing corporation platform.<sup>161</sup> There is also another category of membership available to the entities or persons registered with the clearing corporation for clearing deals or trades on the exchange platform including the deals or trades executed in the derivative segment *namely the self clearing member or the SCM*. The difference between a PCM and an SCM is that a PCM has the right to clear any trade of the members of the derivative segment; whereas an SCM has the right to clear only his own trade(s).<sup>162</sup> PCMs also undertake clearing and settlement responsibilities of the trading members. The PCM in this case has no trading rights, but has clearing rights i.e. he clears the trades of his associate trading members and institutional clients<sup>163</sup>.

### **Post-trade Processes**

The post-trade services constitute the clearing, settlement and custody services. Post-trade processes comprises of the services that are performed subsequent to the execution of a trade, and include: clearing, settlement, including processes preparing for settlement such as affirmation, confirmation, allocation and matching, custody and asset servicing, related activities such as collateralization. In short post-trade processes means and involves every activity that is carried out by various agencies or corporate houses after the trade is complete on the exchange platform and the post-trade activities constitute a series of activities that culminates in actual settlement of the deal transacted on the exchange platform.<sup>164</sup> Settlement of cleared deals follows a calendar. The pay-in and pay-out dates are strictly adhered to by the market participants in order to ensure timely settlement of trades executed on the exchange. Regulation 6.2 of Chapter 6 of both the National Securities Clearing Corporation Limited (Capital Market) Regulations, 1996 and the Indian clearing corporation limited or ICCL Regulations mandates that the board of directors of the clearing corporation or such other authority as may be specified through notification must fix the clearing days, dates and time connected with the clearing and settlement process initiated by the

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<sup>161</sup> Ibid

<sup>162</sup> Supra FN 156

<sup>163</sup> Supra FN 63

<sup>164</sup> Refer to the international audit and financial services firm viz. PWC's (Pricewaterhousecooper's) paper titled 'Post-trade Services in Financial Markets – Moving from backstage to centre stage' published online and made available for reference in digital form at <http://www.strategyand.pwc.com/media/file/Post-trade-services-in-financial-markets.pdf> accessed on the 16th of July, 2016. PWC's url : <http://www.pwc.in/> accessed on the 16th of July 2016.

clearing corporation.<sup>165</sup> The National Securities Clearing Corporation Limited in pursuance of regulation 6.2 of chapter 6 of the National Securities Clearing Corporation Limited (Capital Markets) Regulations, 1996 brings out the settlement calendar each month publishing the schedule of settlement date and time for trades of next month. For instance in the first week of June, 2016 the schedule of settlement dates and time for the month of July 2016 is published by the National Securities Clearing Corporation Limited. A specimen settlement calendar for the capital market segment published by the NSCCL in the month of June is also uploaded on the website of the NSCCL for the prior information of all.<sup>166</sup> The settlement calendar contains the schedule for all types of settlement undertaken by the National Securities Clearing Corporation Limited, for instance, it contains the schedule for normal settlement, settlement schedule for normal auction settlement, settlement schedule for normal bad delivery, settlement schedule for company objections, settlement schedule for limited physical settlement, settlement schedule for trade for trade segment, settlement schedule for trade for trade – S rolling settlement and the settlement schedule for ITP for SME.<sup>167</sup> The table below<sup>168</sup> taken from the NSEIL's educational and research initiative titled '*Indian Securities Market, A Review*', Chapter titled '*Capital Market – Clearing and Settlement*' shows the settlement process of the National Stock Exchange<sup>169</sup>

#### Settlement Cycle in Capital Market Segment of NSE

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<sup>165</sup>Chapter-6 of the National Securities Clearing Corporation Limited (Capital Market) Regulations, 1996 and the ICCL deals with the detailed procedure laid down for settlement of cleared deals. Regulation 6.2 of chapter- 6 of the National Securities Clearing Corporation Limited (Capital Market) Regulations, 1996 and also the ICCL Regulations deals with important scheduled days and time of settlement of cleared deals that needs to be strictly adhered to in order to ensure timely settlement of trades. A copy of the National Securities Clearing Corporation Limited (Capital Market) Regulations, 1996 and the ICCL Regulations are also available in digital form for reference at <https://www.nseindia.com/global/content/regulations/NSCCLCMregulations.pdf> accessed on the 17<sup>th</sup> of July, 2016 and available at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> accessed on the 17<sup>th</sup> of July, 2016 respectively.

<sup>166</sup> Refer to the settlement calendar of capital market segment uploaded on its website by National Securities Clearing Corporation limited and made available for the information of all in digital form at [https://www.nseindia.com/content/nscl/cm\\_sett\\_calendar.pdf](https://www.nseindia.com/content/nscl/cm_sett_calendar.pdf) accessed on the 17<sup>th</sup> of July, 2016

<sup>167</sup> Supra FN 162

<sup>168</sup> The National Stock Exchange of India limited i.e. NSEIL's document titled '*Indian Securities Market, A Review*' (ISMR) chapter on '*Capital Market – Clearing and Settlement*' is published online and is also available in digital form for reference at <https://www.nseindia.com/content/us/ismr2009ch5.pdf> accessed on the 17<sup>th</sup> of July, 2016.

<sup>169</sup>Ibid

Activity	T + 2 Rolling Settlement (From April 1, 2003)
Trading	T
Custodial Confirmation	T+1
Delivery generation	T+1
Securities/Funds Pay-in	T+2
Securities/Funds Pay-out	T+2
Valuation Debit	T+2.
Auction	T+3
Bad Delivery Reporting	T+4
Auction Pay-in/Pay-out	T+5
Close Out	T+5
Rectified Bad Delivery Pay-in/Pay-out	T+6
Re-bad Delivery Reporting	T+8
Close Out of Re-bad Delivery	T+9

T + 1 means one working day after the trade day. Other T+ terms have similar meanings.

Source:NSE

Whereas the compulsory rolling settlement cycle on the Bombay Stock Exchange follows the below steps:

DAY	ACTIVITY
T	<ul style="list-style-type: none"> <li>❖ Trading on BOLT and daily downloading of statements showing details of transactions and margins at the end of each trading day.</li> <li>❖ Downloading of provisional securities and funds obligation statements by member-brokers.</li> <li>❖ 6A/7A* entry by the member-brokers/ confirmation by the custodians.</li> </ul>
T+1	<ul style="list-style-type: none"> <li>❖ Confirmation of 6A/7A data by the Custodians upto 1:00 p.m. Downloading of final securities and funds obligation statements by members</li> </ul>
T+2	<ul style="list-style-type: none"> <li>❖ Pay-in of funds and securities by 11:00 a.m. and pay-out of funds and securities by 1:30 p.m. The member-brokers are required to submit the pay-in instructions for funds and securities to banks and depositories respectively by 10:40 a.m.</li> </ul>
T+2	<ul style="list-style-type: none"> <li>❖ Auction on BOLT at 2.00 p.m.</li> </ul>
T+3	<ul style="list-style-type: none"> <li>❖ Auction pay-in and pay-out of funds and securities by 09:30 a.m. and 10:15 a.m. respectively.</li> </ul>

Source: BSE<sup>170</sup>

In addition to aforementioned the Bombay Stock Exchange Limited also publishes the monthly settlement calendar well in advance for the market participants to adhere to the same. The monthly settlement calendar is uploaded or published on the official website of the Bombay Stock Exchange Limited in pursuance of chapter 6, regulation 6.2 of the ICCL Regulations<sup>171</sup> enacted by the Indian Clearing Corporation Limited.

Post-trade processes form an integral part in discharging obligations entered into at trading level.

In many jurisdictions (other than India) across the world the post-trade services have been out-sourced by the stock exchanges and the post-trade activity is closed by the out-sourced agency. Post-trade service providers process the corporate actions initiated by the issuers and further

<sup>170</sup> Refer to the explanation available in digital form for reference of general public at the official website of the Bombay Stock Exchange Limited at [http://www.bseindia.com/markets/equity/EQReports/tra\\_Settlement.aspx?expandable=6](http://www.bseindia.com/markets/equity/EQReports/tra_Settlement.aspx?expandable=6) accessed on the 18<sup>th</sup> of July, 2016. The page available on the official website of Bombay Stock Exchange limited deals with the settlement procedure adopted by the Bombay Stock Exchange Limited.

<sup>171</sup> A copy of the ICCL Regulations is also available in digital form for reference of market participants and others at <http://www.icclindia.com/downloads/ICCL%20Regulations.pdf> accessed on the 18<sup>th</sup> of July, 2016



carried on by other market participants, for the benefit of investors. Post-trade services industry is an immensely growing industry in Europe and has enormous of market potentials.<sup>172</sup>

### **European Post-trade regulatory reforms:**

The genesis of the European post-trade regulatory reforms majorly started with the setting up and formation of the Giovannini Group, which reviewed the existing set up on clearing and settlement arrangements adopted by the European Commission way back in the year 1996. The Giovannini group of financial market experts was formed in the year 1996 to advise the European Commission on issues pertaining to financial markets.<sup>173</sup> Before the financial crisis of 2007-2008, European post-trade reform focused on efficiency gains through harmonisation and standardisation, aiming to remove the Giovannini Barriers, the determined impediments to integrated low-cost and low-risk European post-trade processes.<sup>174</sup> The group submitted two reports to the European commission. The first Giovannini group report<sup>175</sup> dealt with and assessed the issues plaguing the cross-border clearing and settlement arrangements put in place by various nation states within European Union, while the second Giovannini group report<sup>176</sup> dealt with the European Union's clearing and settlement arrangements. According to the Giovannini report the processes of clearing and settlement are at the core of every financial system; inefficiencies in these processes bear a tremendous serious impact or consequences on the national economy.<sup>177</sup> When clearing and settlement are too expensive or complex, financial transactions are discouraged. According to the second report of the Giovannini Group, in the context of the EU, the result is that national markets

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<sup>172</sup> Supra FN 160

<sup>173</sup> Source: refer to the explanation available in digital form on the official website of the European Central Bank at <https://www.ecb.europa.eu/paym/t2s/about/html/giovannini.en.html> accessed on the 18th of July, 2016

<sup>174</sup> Supra FN 1

<sup>175</sup> A copy of the detailed Giovannini Group's first report is also available in digital form for reference at [http://ec.europa.eu/finance/financial-markets/docs/clearing/first\\_giovannini\\_report\\_en.pdf](http://ec.europa.eu/finance/financial-markets/docs/clearing/first_giovannini_report_en.pdf) accessed on the 18th of July, 2016

<sup>176</sup> A copy of the detailed Giovannini Group's second report is also available in digital form for reference at A copy of the detailed Giovannini Group's first report is also available in digital form for reference at [http://ec.europa.eu/internal\\_market/financial-markets/docs/clearing/second\\_giovannini\\_report\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/clearing/second_giovannini_report_en.pdf) accessed on the 18th of July, 2016

<sup>177</sup> Refer to the 'foreword' written by Mr. Alberto Giovannini to the Giovannini group's second report clearing and settlement arrangements in securities markets under the European Commission's supervision. A copy of the detailed Giovannini Group's second report is also available in digital form for reference at A copy of the detailed Giovannini Group's first report is also available in digital form for reference at [http://ec.europa.eu/internal\\_market/financial-markets/docs/clearing/second\\_giovannini\\_report\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/clearing/second_giovannini_report_en.pdf) accessed on the 18th of July, 2016

have remained isolated: resources are not pooled efficiently, the allocation of economic resources across time and space remains sub-optimal, the techniques that allow the trading of risk have been too expensive and financial asset prices fail to convey all information that is available to market participants.<sup>178</sup> As a result of the lessons learned from the 2007- 2008crisis, a fundamental shift resulting in focus toward safety measures characterized the post-crisis regulatory initiatives and reforms.<sup>179</sup>

### **Regulatory Framework Governing Clearing in European Securities Market:**

Clearing involves matching a buyer for every seller and a seller for every buyer in a securities transaction, thus reducing counterparty risk. A well-regulated clearing and settlement system is crucial for the efficient operation of the economy, making it stronger every passing day. An important role for public policy therefore is to ensure that these systems function well when confronted with market stresses and adversaries. The 2007-2009 global credit crises exposed the inherent vulnerabilities present in the European Union's clearing and settlement system.<sup>180</sup> In particular the global credit crisis of 2007-2009, revealed the existing weaknesses in controlling systemic risk and liquidity risk. As a result, the system of financial regulation came under closer scrutiny because of its potential for systemic and other financial risks that threaten financial stability and economic development of the member states of the European Union.<sup>181</sup> This has also been revealed in the report of the European Parliament on the 'Clearing and Settlement in the EU'. The European Parliament is an important forum for political debate and decision-making at the EU level.<sup>182</sup> The European Parliament acts as a co-legislator, sharing with the European Council<sup>183</sup> the power to adopt and amend legislative proposals and to decide on the EU budget.<sup>184</sup> It also supervises the work of the Commission and other EU bodies and cooperates with national

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<sup>178</sup> Ibid

<sup>179</sup> Supra FN 1

<sup>180</sup> Refer to the report of the European Parliament; Director-General of Internal Policies; Department of Economic and Monetary Affairs' report on the '*Clearing and Settlement in the EU*'. The report is also available digital form for reference at [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2009/416242/IPOL-ECON\\_ET\(2009\)416242\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2009/416242/IPOL-ECON_ET(2009)416242_EN.pdf) accessed on the 24<sup>th</sup> of July, 2016

<sup>181</sup> Ibid

<sup>182</sup> Refer to the official website of the European Parliament at <http://www.europarl.europa.eu/aboutparliament/en> accessed on the 24<sup>th</sup> of July, 2016.

<sup>183</sup> More information about the European Council is also available at the official website of the European Council at <http://www.consilium.europa.eu/en/european-council/> accessed on the 24<sup>th</sup> of July, 2016.

<sup>184</sup> Supra FN 181

parliaments of EU countries to get their input.<sup>185</sup> The European Parliament is made up of 751 Members elected in the 28 Member States of the enlarged European Union.<sup>186</sup>

In an attempt to enhance investor protection, promote financial stability and put in place an orderly financial market supervision amongst the member states of European Union in the post credit crisis period i.e. during the 2007- 2009 period, the European Union established the **European Securities and Markets Authority (ESMA)**.<sup>187</sup> The ESMA has been established as a result of the direct recommendation of the **High Level Group on Financial Supervision in the EU**.<sup>188</sup> The *High Level Group on Financial Supervision in the EU*<sup>189</sup> submitted its report in the year 2009 and formation of ESMA was one of the major recommendations of the *High Level Group on Financial Supervision in the EU*. The *High Level Group on Financial Supervision in the EU* was chaired by Jacques De Larosiere and the *High Level Group on Financial Supervision in the EU*'s report is commonly known as the De Larosiere report. ESMA started its operations on the 1<sup>st</sup> of January, 2011 and it replaced the **Committee of European Securities Regulators (CESR)** which has been operating as a network of EU authorities then.<sup>190</sup> CESR promoted consistent supervision across the European Union (EU) and provided advice to the European Commission. ***Though ESMA is an independent EU Authority, it has complete accountability towards the European Parliament, the European Commission and Council of European Union.***<sup>191</sup> The representatives of ESMA also have to appear before the Economic and Monetary Affairs Committee (ECON) for formal hearings, whenever the need for the same arises. ESMA endeavors to achieve its mission and objectives by adhering to four main activities. They are as follows<sup>192</sup>:

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<sup>185</sup> Supra FN 181

<sup>186</sup> Refer to the information available at the official website of the European Parliament at <http://www.europarl.europa.eu/aboutparliament/en/20150201PVL00010/Organisation-and-rules> accessed on the 24th of July, 2016

<sup>187</sup> Refer to the 'mission and objectives' statement of the European Securities and Markets Authority (ESMA) available at the official website of the ESMA for reference at <https://www.esma.europa.eu/about-esma/who-we-are> accessed on the 25th of July, 2016

<sup>188</sup> Refer to the short 'History' of ESMA available at the official website of ESMA for reference at <https://www.esma.europa.eu/about-esma/who-we-are> accessed on the 25th of July, 2016.

<sup>189</sup> A copy of the report of the *High Level Group on Financial Supervision in the EU*, commonly known as the *De Larosiere Report* is also available in digital form for reference at [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf) accessed on the 25th of July, 2016.

<sup>190</sup> Supra FN 187

<sup>191</sup> Refer to the information available on the official website of the European Securities and Markets Authority (ESMA) at <https://www.esma.europa.eu/about-esma/who-we-are> accessed on the 25th of July, 2016.

<sup>192</sup> Supra FN 190

- Assessing risks to investors, markets and financial stability
- Completing a single rulebook for EU financial markets
- Promoting supervisory convergence
- Directly supervising specific financial entities like the Credit Rating Agencies (CRAs) and the Trade Repositories (TRs) etc.<sup>193</sup>

ESMA plays a vital role in the post-trading area. ESMA's chief functions in the post-trade area are the implementation of the EMIR regulations on the EU's markets infrastructure (EMIR) institutions and central securities depositories (CSDR).<sup>194</sup> ESMA also co-ordinates the issues such as settlement discipline and Target2-Securities (T2S), and provides information on the Settlement Finality Directive (SFD).<sup>195</sup>

In the area of clearing, *EMIR, the European Markets Infrastructure Regulation of 2012*,<sup>196</sup> covers clearing obligations, the regulation of CCPs and obligations to report to Trade Repositories, EMIR regulation is currently being implemented by the European Commission. ***On 4 July 2012, the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (known as "EMIR" - European Market Infrastructure Regulation<sup>197</sup>) was adopted by the European Parliament and the same came into force on 16 August 2012.***<sup>198</sup> The event of adoption of the Regulation on OTC derivatives, Central Counterparties and Trade Repositories (commonly known as the European Markets Infrastructure Regulations of 2012)<sup>199</sup> happens to be a major development for the nation states of European Union because the adoption of the EMIR enabled the European Union to deliver on its G20 commitments on OTC derivatives agreed in Pittsburgh in September

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<sup>193</sup> Ibid

<sup>194</sup> Refer to the official website of the European Securities and Markets Authority. The information is available in digital form at <https://www.esma.europa.eu/regulation/post-trading> accessed on the 25th of July, 2016

<sup>195</sup> Supra FN 193

<sup>196</sup> A copy of the European Markets Infrastructure Regulations, 2012 is also available for reference in digital form at the official website of the European Parliament at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&from=EN> accessed on the 25<sup>th</sup> of July, 2016

<sup>197</sup> Ibid

<sup>198</sup> Refer to the official website of the European Commission. The information on the date of adoption of the Regulation on the OTC derivatives, Central Counterparties and Trade Repositories or commonly known as the European Markets Infrastructure Regulations, 2012 and other information connected with the event of adoption of EMIR is available at [http://ec.europa.eu/finance/financial-markets/derivatives/index\\_en.htm](http://ec.europa.eu/finance/financial-markets/derivatives/index_en.htm) accessed on the 26th July, 2016.

<sup>199</sup> Supra FN 195



2009.<sup>200</sup> Title – II<sup>201</sup> article 4 and article 5 of the EMIR deals with the clearing obligation and clearing obligation procedure to be followed by the member states of European Union respectively. Article -9<sup>202</sup> of the EMIR deals with the reporting obligations counterparties and the central counter parties to the trade repository<sup>203</sup>. Article- 2(2) of the EMIR defines the term ‘trade repository’ as a legal person that centrally collects and maintains records of derivatives.<sup>204</sup> Title- VI of the EMIR deals with the registration and supervision of the trade repositories. Chapter – 1 of Title – VI of the EMIR deals with the conditions and procedure for registration of a trade repository. Title – VI, chapter – 1 Article 55 of the EMIR deals with the registration of a trade repository.<sup>205</sup>

The EMIR primarily deals with clearing and settlement of deals struck between the buyer and the seller in the OTC derivative markets of the member states of the European Union.<sup>206</sup> These regulations have been enacted by the European community because of the reason that the guaranteeing of the clearing and settlement OTC derivatives trade is an extremely challenging task especially in the wake of the recent financial crisis of 2007- 2009, reeling the European and American nations and having an adverse, deeper impact on global financial health. The EMIR is more focused on setting up or rather building up proper market infrastructure so the OTC derivatives trade can be cleared and finally settled without default.<sup>207</sup> It is pertinent to mention that the non – settlement of the OTC derivatives trades was one of the strong reasons/ factors contributing to the ultimate triggering of the global financial credit crisis reeling the world economy during the period of 2007- 2009. Hence the justification for the enactment of the EMIR and the reason why the EMIR came into existence?

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<sup>200</sup> Supra FN 197

<sup>201</sup> Title-II of the European Markets Infrastructure Regulations, 2012 deals with the clearing, reporting and risk mitigation of the OTC derivatives on the European country exchanges. A copy of the European Markets Infrastructure Regulations, 2012 is also available for reference in digital form at the official website of the European Parliament at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&from=EN> accessed on the 25<sup>th</sup> of July, 2016

<sup>202</sup> Supra FN 195

<sup>203</sup> Article- 2(2) of the EMIR defines the term ‘trade repository’. A copy of the European Markets Infrastructure Regulations, 2012 is also available for reference in digital form at the official website of the European Parliament at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&from=EN> accessed on the 25<sup>th</sup> of July, 2016

<sup>204</sup> Ibid

<sup>205</sup> Ibid

<sup>206</sup> Supra FN 195

<sup>207</sup> Ibid

However, in addition to the various EU regulations, the individual stock exchanges and the member states of the European Union have their own set rules regulating the clearing and settlement activities of the concerned stock exchange. For instance, the London Stock Exchange has its own set of rules known as the *Rules of the London Stock Exchange*<sup>208</sup> to regulate various activities in the securities market. The Rules of the London Stock Exchange contains rules for regulating the clearing and settlement activities of the London Stock Exchange (i.e. LSE). The Rules of the London Stock Exchange are read with the Financial Services and Markets Act, 2000<sup>209</sup> of UK to get a more holistic view of the regulatory framework governing trading, clearing and settlement mechanism of the London Stock Exchange. Part – XVIII<sup>210</sup> of the Financial Services and Markets Act, 2000 deals with the regulatory aspects of the *Recognised Investment Exchange and Clearing Houses* in the UK.

### **Regulation of Process of Securities Trade Settlement in European Union**

Settlement is a process involving the irrevocable delivery of a security in a transaction for payment (usually cash). Banks and brokers act as investors' intermediaries and are involved in the process of settling trades of securities in book entry form, and in providing access to CSDs. In the area of securities settlement, the CSD Regulation (CSDR)<sup>211</sup> covers inter alia the improvement of securities settlement (including the shortening of the settlement cycle to T+2) and the regulation of CSDs. In addition, Target2-Securities, T2S, the pan-European settlement project initiated by the European Central Bank (ECB), will go live from 2015-17.

### **Custody and asset servicing**

These services comprise the safekeeping of assets by intermediary banks, brokers and CSDs on behalf of investors, as well as carrying out asset servicing functions such as income collection,

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<sup>208</sup> A copy of the Rules of the London Stock Exchange is also uploaded and made available in digital for reference at <http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/rules-lse.pdf> accessed on the 26th of July, 2016

<sup>209</sup> A copy of the Financial Services and Markets Act, 2000 (U.K) is also available in digital form for reference at <http://www.legislation.gov.uk/ukpga/2000/8/contents> accessed on the 26th of July, 2016

<sup>210</sup> Part –XVIII of the Financial Services and Markets Act, 2000 (U.K) is also available in digital form for reference at <http://www.legislation.gov.uk/ukpga/2000/8/part/XVIII> accessed on the 26th of July, 2016

<sup>211</sup> A copy of the Central Securities Depositories Regulations, 2014 is also available in digital form for reference at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0909&from=EN> accessed on the 28<sup>th</sup> of July, 2016.

corporate action processing, tax reclamation and proxy voting services. Custody services are defined as ancillary services under the Markets in Financial Instruments Directive 2 / Regulation (MiFID 2/MiFIR), while the amendment to the Shareholders Rights Directive, proposed by the Commission in April 2014, inter alia aims at broadening the obligations of intermediaries. Through private sector initiatives, best market practices have been developed using market standards for corporate actions processing and for general meetings to facilitate the exercise of rights flowing from securities held – these are currently being implemented in all European markets. Initiatives in the area of investment funds (mutual funds, unit trusts, exchange traded funds etc.) also have a significant impact upon post-trade processes. These initiatives include legislation (notably the Undertakings for Collective Investment in Transferable Securities, UCITS, and the Alternative Investment Fund Managers Directive, AIFMD), as well as private sector work by the International Securities Services Association (ISSA), the European Fund and Asset Management Association (EFAMA) and others.

## **Reform**

Important milestones have been achieved in the process of European post-trade reform. However, the following gaps need to be closed: • action by the EU authorities to resolve outstanding legal issues such as eliminating legal uncertainties and the creation of a consistent conflict-of-laws regime • enacting enforceable solutions to withholding tax procedural issues – likely to be based on the EC Recommendation on withholding tax relief procedures of 2009<sup>2</sup> and the Tax Barriers Business Advisory Group (T-BAG) Report of 2013<sup>3</sup> • creation of a recovery and resolution regime for CCPs and CSDs that offer banking services, based on the CPSS-IOSCO principles. Such a regime will be an important element of risk mitigation In AFME's view, a synthesis of efficiency and safety and the combination<sup>4</sup> of public sector authority and private sector expertise and experience is crucial to conclude the process of European post-trade reform successfully.

The creation of an integrated and efficient European capital market is one of the most important and ambitious projects currently underway in the European Union. Europe needs developed, reliable and effective capital markets to provide: (i) diverse mechanisms for the financing of economic activities; and (ii) alternatives for investors' savings allocations. Since 1999, when the

Financial Services Action Plan was launched, considerable progress has been made towards this goal, both in terms of legislative measures and market integration. A crucial element of this framework is the safety and efficiency of the arrangements required to finalise securities transactions ('clearing and settlement'). These arrangements, largely invisible to the retail investor, lie at the core of modern capital markets and are indispensable for their proper functioning. *The trading of securities – buying and selling financial securities such as shares and bonds for cash – is a well-known area, regularly covered and discussed by media. Less known is the area of Post Trade, where, after the trade has been carried out, the buyer ultimately receives securities and the seller receives cash. The exchange of cash and securities is normally carried out using a simultaneous electronic process known as Delivery versus Payment (DvP), which ensures that neither party can end up with both the securities and the cash (with the other party holding nothing). The term 'Post Trade' also includes the custody of securities in Central Securities Depositories – either as paper certificates or as computer records.* Banks may intermediate by holding the securities as custodian in the depositories on behalf of investors; in such cases, banks are often known as intermediaries. The route to settlement is complex, and involves confirmation, matching and clearing of trades before they can be passed for settlement.

**Conclusion:** In this research paper the researcher tried to demystify the post-trading mechanism prevalent in India and tried comparing the same with that of European Union and its member countries esp. UK. The researcher also made an attempt to compare the nature of Indian post-trade regulations with that of USA. *The European Union's regulations (for instance regulations like EMIR) on clearing and settlement which is primarily focused on proper infrastructure building by its member nation states so that clearing and settlement of securities trades can be guaranteed to the market participants operating within the European Union. The other aspect of post-trade regulations like the regulations (apart from infrastructure building regulations) for regulating other market participants like the clearing members, the clearing banks etc. that operate in the securities clearing and settlement area are left to the individual stock exchanges of the nation states forming part of the European Union to regulate.*

Another important point of distinction that comes to the notice of the researcher while researching on clearing and settlement regulations of EU, UK and USA and comparing the same with its Indian counterpart is that *the EU, UK and US regulations on securities market (including clearing and*



*settlement regulations) comes attached with elaborate ‘guidance notes’<sup>212</sup>, ‘possible interpretation’ ‘supplementary materials’[for instance refer to the ‘supplementary material’ attached to the New York Stock Exchange’s rule 46 on ‘Dealings and Settlements’ (rule 45-299C )<sup>213</sup>] and other clarifying ‘notes’ etc. to the legal provisions contained in these regulations etc. making it easier for the market participants to comprehend and follow the same in its letter and spirit, whereas in India except the newly enacted Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015<sup>214</sup> [ for instance, check ‘notes’ component attached to regulation 2(1) (d) (ii) (j) of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015<sup>215</sup> enacted by SEBI] no other regulations enacted by the market regulator, SEBI comes attached with either ‘guidance note’ or ‘possible interpretation’ component to enable the market participants understand or comprehend the intentions of regulator behind enacting these provisions clearly. The text on ‘guidance note’, ‘possible interpretations’ and ‘supplementary material’ etc. attached to the securities market regulations assume more significance esp. in the wake of the relatively poor financial literacy rate prevailing in India. According to the researcher the securities market regulator in India i.e. SEBI may draw from the prevailing international practices (esp. from the UK and US jurisdictions) and consider attaching ‘guidance notes’, ‘possible interpretation’, ‘supplementary materials’ and other ‘clarifying notes’ to the rules, regulations etc. while enacting the same for the ease of understanding of the market participants. This practice also helps the securities market regulator’s intent, views and ideas trickle down to market participants as a result of which the practice provides a further boost to voluntary compliance mechanism put in place by the regulator for the market participants. This in effect contributes to ensuring and implementing the market discipline in a smooth manner.*

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<sup>212</sup> Refer to the ‘Guidance to rule’ component of the ‘Rules of the London Stock Exchange’ uploaded and made available in digital form for reference at <http://www.londonstockexchange.com/traders-and-brokers/rules-regulations/rules-lse.pdf> accessed on the 27th of July, 2016

<sup>213</sup> A copy of the New York Stock Exchange’s Rules (NYSE Rules) on ‘Dealings and Settlements’ is also available in digital form at [http://nyserules.nyse.com/nysetools/PlatformViewer.asp?SelectedNode=chp\\_1\\_3&manual=/nyse/rules/nyse-rules/](http://nyserules.nyse.com/nysetools/PlatformViewer.asp?SelectedNode=chp_1_3&manual=/nyse/rules/nyse-rules/) accessed on the 27th of July 2016

<sup>214</sup> A copy of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 is also available in digital form for reference at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1421319519608.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1421319519608.pdf) accessed on the 27th of July, 2016

<sup>215</sup> Supra FN 214

There are also certain other sectors in which trading have been banned by the SEBI i.e. the market regulator in India. For instance, trading in forward contracts has been banned by the market regulator, SEBI, as the same entails settlement in terms of actual delivery of goods or underlying assets and the same cannot be settled by delivering cash instead of the goods contracted for as per the contract terms. In this regard and according to the author, SEBI as a regulator is much more equipped technologically and also otherwise to regulate the forwards contract compared to its predecessor in the same segment i.e. FMC and hence should not have banned the products like forwards contract from trading on the exchange platform only because of the strong challenges this sector poses to the regulator or the exchanges in the ultimate settlement of trades.

