

FORWARD TRADING IN SHARES

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"Free Enterprise was born with man
and shall survive as long as man
survives".

-A.D. Shroff

1899-1965

Founder-President

Forum of Free Enterprise

FORWARD TRADING IN SHARES

By

M.R. MAYYA*

Forward trading in shares, popularly known as badla trading, and now as carry forward transactions, has existed in this country for nearly 100 years. Towards the end of the last century, there used to be three types of transactions on the Bombay Stock Exchange, viz. (i) 'Tran Kagalia' or three papers consisting of the application form, the transfer deed and the share certificate where the buyer had to pay cash against delivery of documents on the day of the transaction or on the next day, (ii) ready delivery transaction where the buyer had to pay against delivery in about eight days' time from the date of transaction, and (iii) transaction for delivery and payment on a monthly settlement basis. These were converted into fortnightly clearings in 1946 and called as "contracts for the clearing" under the bye-laws and regulations of stock exchanges. "Contracts for the clearing" are defined under the bye-laws of stock exchanges as "contracts for clearance and settlement through the clearing house" in the manner prescribed in the bye-laws and regulations of stock exchanges. Trading in these contracts was prohibited by Government of India on June 27, 1969.

TRADING IN SPECIFIED SHARES

After a gap of about 14 years, forward trading in shares was permitted by Government of India in 1983 at the

The author was formerly Executive Director of the Bombay Stock Exchange. The article was written in April 1996.

Bombay, Calcutta, Delhi and Ahmedabad Stock Exchanges under the nomenclature of specified shares with the bye-laws and regulations of these exchanges being duly amended and without rescinding the June 27, 1969 notification banning trading in "contracts for the clearing."

At the Bombay, Calcutta and Delhi and Ahmedabad Stock Exchanges, securities are divided into two main categories, viz. specified shares and non-specified securities. Both specified shares and non-specified securities are traded as hand delivery contracts.

HAND DELIVERY CONTRACTS

A hand delivery contract is defined under the bye-laws of stock exchanges as a contract for delivery and payment within a period of not more than 14 days following the date of the contract. In actual practice, however, there is generally a trading cycle of 14 days (which has recently been reduced to 7 days at some of the stock exchanges) and at the end of this trading cycle, the positions are netted out and delivery of securities and payment thereof take place on the basis of outstanding positions at the end of the trading cycle.

In the case of specified shares, delivery and payment in a hand delivery contract can be extended or postponed by further periods of 14 days each so that the overall period does not exceed 90 days from the date of the contract.

Trading in specified shares is exactly akin to trading in "contracts for the clearing" prohibited by Government of India on June 27, 1969.

BAN BY SEBI

Trading in specified shares was banned by the Securities and Exchange Board of India (SEBI) on December 13, 1993.

At the time of prohibition on December 13, 1993, there were equity shares of 94, 45, 43 and 21 companies at the Bombay, Calcutta, Delhi and Ahmedabad Stock Exchanges respectively traded as specified shares and with 70 shares being common among them, the number of specified shares was 133. These had a total market capitalisation of about Rs.21,000 crore, accounting for about 60 per cent of the total stock market capitalisation of about Rs.350,000 crore in the country.

PERFORMANCE OF CONTRACTS IN SPECIFIED SHARES

Under the bye-laws of stock exchanges, a contract in specified shares can be for spot delivery or for hand delivery or for special delivery or for the settlement and unless otherwise stipulated when entering into the contract, the contract is deemed to be for the current settlement. A contract entered into for the current settlement can be performed by any one of the following three ways : i) Delivery against a sale contract can be given and delivery against a purchase contract received and payment made at the contract rate. ii) A purchase contract can be off-set by a sale contract and a sale contract by a purchase contract during the settlement period and the difference in prices settled. iii) A contract, in respect of which delivery is not given or taken and which is not off-set by an opposite transaction during the settlement period, can be carried over to the next settlement period at the making-up price fixed by the stock exchange authorities in this behalf which is

generally based on the closing quotation of the share on the last trading day of the settlement period and the difference between the contract rate and the making-up price settled.

Among the sellers and buyers, who have outstanding positions at the end of a settlement, there are four categories, viz., i) Sellers who want to give delivery. ii) Sellers who do not want to give delivery. iii) Buyers who want to take delivery. iv) Buyers who do not want to take delivery.

There is generally a mis-match between the sellers who want to give delivery and the buyers who want to take delivery. If the quantum of sales of sellers wanting to give delivery exceeds the quantum of purchases of buyers desiring to take delivery, financiers known as "vyaj badlawalas" emerge who take delivery in the current settlement from the sellers giving the delivery and give delivery in the next settlement to the buyers carrying forward the transactions receiving the differences between the settlement rate in the current settlement and the sale rates for the next settlement as interest charges. This is known as contango or 'seedha badla' and the transaction is known as 'vyaj badla' or 'mandi badla'. If, on the other hand, the quantum of purchases by buyers wanting to take delivery exceeds the quantum of sales of sellers desiring to deliver, share financiers, known as 'teji badlawalas' come on the scene who give delivery in the current settlement to the buyers at the settlement rate and take back delivery in the next settlement from the sellers at lower sale rates receiving the differences between the two rates as charges, for lending such shares. This is known

as backwardation or 'ulta badla' and the transaction is known as 'mal-badla' or 'teji badla.

MODUS OPERANDI OF 'VYAJ BADLA'

The modus operandi of 'vyaj badla' can better be appreciated by way of an illustration given below :

- i) A client (say R) informs Broker (say A) about his willingness to invest say Rs.1,00,000/- by way of badla finance. He may, if he so desires, indicate the minimum rate of the return and also indicate the choice of the scrips in badla financing.

- ii) Broker A enters the badla session held on the day following the last day of trading of a current settlement period of 14 days (Settlement No.1) but before commencement of trading in the next settlement period of 14 days (Settlement No.2) for carrying forward the transactions of the current settlement period and tries to ascertain the prevailing badla rate. If he finds the badla rate of say Rs.2 in a scrip say TISCO attractive, he immediately decides to purchase 500 shares of TISCO at the rate of say Rs.200 per share in the current settlement from Broker B who has a purchase position in the current settlement and who desires to carry forward the same to the next settlement. The money of Rs.1,00,000 of client R is thus invested in badla financing. This purchase contract of Broker A in the current settlement would simultaneously result in a sale contract in the next settlement at the rate of Rs.200 + Rs.2 i.e. Rs.202. This would give to the client a return at the rate of Rs.2 for Rs.200 i.e. Re.1 for Rs.100 in

a fortnight which means a return of Rs.2 for Rs.100 per month and Rs.24 per Rs.100 per year which works to an annual return of 24 per cent reckoned on a simple interest basis. So far as Broker B is concerned, his purchase contract in the current settlement would have been offset by a sale contract and he would have a fresh purchase contract in the next settlement at Rs.202.

- iii) Before the pay-in-day of the current settlement, client R would have to pay Broker A the amount of Rs.1,00,000 and on the pay-in-day, Broker A would make payment of Rs.1,00,000 to the clearing house of the stock exchange. On the pay-in-day, Broker C who would be having a sale contract of 500 shares in TISCO in the current settlement would deliver to the clearing house 500 shares of TISCO. On the pay-out-day, these shares would be delivered by the clearing house to Broker A and the clearing house would also pay to Broker C the amount of Rs.1,00,000/-. Broker A in turn would deliver the shares to client R and Broker C would pay to his client who has sold the shares the amount of Rs.1,00,000 minus brokerage.
- iv) Client R who receives 500 shares of TISCO from Broker A on the pay-out day and who is in constructive possession of the shares is rightful and legal owner of these shares.
- v) In the next settlement, client R who has received 500 shares of TISCO would be delivering the same in the market through Broker A.

- vi) If client R finds that it is remunerative for him to continue badla operation in TISCO, he would be purchasing 500 shares of TISCO in the badla session of Settlement No.2. His sale position in this settlement would thus have been squared up. This would simultaneously result in a sale position in Settlement No.3 on his investment of Rs.1,00,000 and the difference between the purchase price of Settlement No.2 and the sale price of Settlement No.3 would be the badla that he would be realising for Settlement No.3 and the process can go on endlessly. There is, however, a possibility of the prices varying from Rs.200 at which Broker A bought the shares of TISCO in the badla session of Settlement No.1. If the price of purchase in Settlement No.2 is say Rs.210, client R has to pump in an additional amount of Rs.5,000 (i.e. 500×10). If on the other hand, the price of purchase is say Rs.190, client R receives Rs.5,000 being the difference in prices.
- vii) If client R, however, finds that it is more remunerative for him to enter into badla transaction in say TELCO in Settlement No.3, he would deliver 500 shares of TISCO on the due date in Settlement No.2 and the process of taking delivery of TELCO shares in Settlement No.2 would be undertaken in the same manner as he has done in respect of the delivery of shares of TISCO in Settlement No.1.
- viii) In case there is a book-closure in a company, the procedure differs slightly as follows : a) The badla rate is fixed for 28 days instead of 14 days i.e. for the two settlement periods together. b) The financier sends the shares to the company for registration in his name.

MODUS OPERANDI OF 'MAL BADLA'

The modus operandi of 'mal badla' is explained below:

- i) If Broker X finds in the badla session held after the current settlement (Settlement No.1) that the shares of say Indian Rayon are attracting 'ulta badla' at the rate of say Rs.3 he may decide to do 'mal badla' on his own account if he has the shares of Indian Rayon or on account of a client of his possessing the shares of Indian Rayon. Broker X will then sell say 100 shares of Indian Rayon at say Rs.500 in the current settlement to Broker Y who has a sale position in the current settlement and who wants to carry forward the same to the next settlement (Settlement No.2). The sale contract of Broker X in the current settlement would result in a purchase contract in the next settlement at the rate of Rs.500-Rs.3 i.e. Rs.497. This would give to Broker X a return of Rs.3 on Rs.500 in a fortnight i.e Rs.6 on Rs.500 in a month which comes to Rs.72 in a year i.e which works out to an annual return of 14.4 per cent on a simple interest basis. So far as Broker Y is concerned, his sale contract in the current settlement would be offset by a purchase contract and he would have a fresh sale contract in the next settlement at Rs.497.
- ii) On the pay-in-day, Broker X would deliver to the clearing house of the stock exchange 100 shares of Indian Rayon. On the pay-out-day, while Broker X would receive from the clearing house payment of Rs.50,000 (i.e price of 100 shares at the rate of Rs.500), Broker Z, who would be having a purchase contract of 100

shares in Indian Rayon in the current settlement, would receive these shares from the clearing house against the payment made by him on the pay-in-day.

- iii) In the next settlement, Broker X would be receiving on the pay-out day 100 shares of Indian Rayon against payment of Rs.49,700/- (i.e. 100 x Rs.497).
- iv) If Broker X finds that it is worthwhile for him to continue his 'mal badla' operation in Indian Rayon, he would be selling 100 shares of Indian Rayon in the badla session of Settlement No.2. His purchase position in this settlement would thus have been offset by a sale position with a simultaneous purchase position in Settlement No.3 and the difference between the sale price of Settlement No.3 and the purchase price in Settlement No.2 would be the 'ulta badla' that he would be realising for Settlement No.3 and the process can go on endlessly. In actual practice, this does not take place because 'ulta badla' is normally a temporary phenomenon in any given share.
- v) Unlike in 'vyaj badla' where money can be switched from one share to another depending on the rate of return in the 'seedha badla' rates, in 'mal badla', such switching operations are difficult as one needs to have in his possession the shares of the company attracting 'ulta badla'.

CARRY FORWARD CHARGES

Charges for carrying forward the transactions are determined by market forces. These charges, which vary in the half an hour badla session from scrip to scrip and also in the same

scrip, depend upon various factors like prevailing interest rates, technical position of the market, etc. As carry forward of outstanding positions would not be complete in the open out cry session, weighted average carry forward rates are announced by seasoned operators towards the close of the session and all the remaining outstanding positions are carried over to the next settlement at these weighted average rates.

It is pertinent to note that there is no compulsion whatsoever either for the buyer or for the seller to carry forward the transactions. They do so on their own volition. If a buyer insists on delivery and the seller does not have the shares, the stock exchange authorities automatically move in and effect the auction at the cost and risk of the defaulting seller who will then be called upon to pay the difference between the contract price and the price at which the shares are bought in auction. Similarly, if a seller insists on delivery and the buyer does not pay for the shares, the stock exchange authorities auction out the shares at the cost and risk of the defaulting buyer who has then to pay the difference between the contract price and the price at which the shares are sold.

Payment of charges by the buyer to the seller is only because the contractual rights and obligations are frozen at the contract rate the moment a contract is struck and the buyer having thus wrested from the seller all rights relating to the shares including dividend, bonus, rights, etc. and seeking to postpone payment for the same, has to pay a consideration for that. This applies equally to the short seller as carrying forward the transaction is totally an act of volition.

In fact, it is the short seller who imparts sobriety to the carry forward rates. While 'vyaj badlawala' can insist on high rates of carry forward charges, it is the short seller who balances these rates and larger the component of short sales, lower will be these rates. A relatively higher proportion of short sales can and occasionally does not lead to payment of charges by the seller to the buyer.

BENEFITS OF CARRY FORWARD TRANSACTIONS

Carry forward facility injects liquidity into the trading system. Speculative transactions that can be carried forward from one settlement to another permit operators to take a long-term view of the market and thus enable them to come forth constantly with purchase and sale orders at varying levels of prices depending upon their perception of the market. A market, transactions in which are marked by payment and delivery or compulsory closure of the transaction by an opposite transaction within the trading cycle, per force become illiquid with relatively small orders for actual delivery leading to sharp oscillations in prices. This is why fluctuations in prices in non-specified securities have been larger than in specified shares, of course, when the carry forward facility is permitted.

Carry forward system also helps in moderating the extreme movement of prices as it facilitates short selling in a rising market and long purchases in a declining market. Short sales tend to arrest the rise in prices while long purchases help to push up the prices. Empirical studies, albeit limited, conducted in this behalf support this proposition. The sharp rise witnessed in 1994 when the Bombay Stock Exchange Sensitive Index shot up to 4643.31 on September 12, 1994

and the subsequent downslide with the Index dipping to 2996.84 on May 2, 1995 could have been moderated had the facility of carry over been there.

Another significant service, almost indispensable in a market economy, that the carry forward system provides is that it acts as a risk-hedging instrument like options and futures but much more effectively. Anyone, be it a mutual fund or anyone also, holding securities can hedge against a likely fall in prices by selling in the carry forward market. If the prices do decline, the losses in the holdings would be offset by the gains in the carry forward market. In the like manner, any person anticipating a future cash flow can hedge against a likely rise in prices by buying in the carry forward market. If the prices do rise, the gains in the carry forward market would offset the additional costs that he would have to pay because of the rise in prices in the cash market.

PATEL COMMITTEE RECOMMENDATIONS

The positive and constructive services rendered by the carry forward system with the ingrained facility for speculation are ignored and a few of its abuses like the occasional excesses that had taken place in the past have been blown out of proportion and the system itself blamed. As "The Economist", London, in its October 10, 1992 issue pointed out "Speculators are public servants. In a market economy, the job they do is indispensable. And because they work in a cruelly competitive business, you can be sure that those who prosper in it are competent. When in the course of their duties, they appear to cause economic harm, something had indeed gone wrong - but the blame lies elsewhere".

There is nothing wrong in the carry forward system as such, while no doubt the carry forward facility, can always be improved upon. It was to look into this system objectively that SEBI appointed on February 22, 1995, a committee under the Chairmanship of Shri G.S. Patel, former Chairman of Unit Trust of India and Chairman of the High Powered Committee on Stock Exchange Reforms (1985-86) with Shri Deepak S. Parekh, Chairman, Housing Development Finance Corporation Ltd., and Shri M.R. Mayya, former Executive Director, Bombay Stock Exchange, as members and Shri Rajiv Nabar, Division Chief, Secondary Markets, SEBI, as Secretary, to review the system of carry forward transactions in the stock exchanges. The Committee, after a thorough examination of the matter, recommended, in its report submitted on March 20, 1995, resumption of carry forward transactions with a complete set of built-in safety valves and overall surveillance, monitoring and audit. The carry forward system suggested by the Committee is different from the system prevalent earlier in respect of the following five principal matters :

- i) In order to ensure greater transparency into the operations, resumption of trading has to be preceded by the facility of screen-based trading.
- ii) At the end of each trading day, transaction would be demarcated and reported separately for (a) delivery, (b) jobbing, and (c) carry forward, with trading on own account of a member also shown separately under these three heads. Transactions marked for delivery must result in delivery in the settlement period itself and can neither be offset by an opposite transaction nor carried forward.

- iii) Carry forward session would be permitted only after the gross buy and sell outstanding positions, with give delivery /take delivery positions being indicated by each member, scrip-wise, are announced.
- iv) 'Vyaj badla' financiers would not be permitted to square up their positions and the shares received by them would be kept in safe custody in the clearing house of the stock exchange.
- v) In order to ensure that no transaction is carried forward beyond 90 days, each transaction carried over from Settlement No.1 would be identified by a transaction I.D. and the same would be continued on every carry forward to subsequent settlements. This would be supplemented by a monthly certificate from an auditor to the effect that no transaction has been carried forward beyond 90 days from the original date of the contract.

SEBI'S REVISED CARRY FORWARD SYSTEM

SEBI, at its meeting held on July 27, 1995, to discuss the recommendations of Patel Committee accepted the fact of "illiquidity problem afflicting the market" and decided to introduce a revised carry forward system. This was an acceptance that the argument hitherto advanced about the market being liquid, taking mainly the yardstick of deliveries was not based on sound logic.

There was general acceptance of almost all the conditions stipulated by SEBI based mostly on the recommendations if Patel Committee except with regard to two points, viz.

of Patel Committee except with regard to two points, viz. (i) limits on the broker-wise outstanding position on any day in respect of carry forward transactions, and (ii) margins on carry forward transactions. These are dealt below.

BROKER-WISE OUTSTANDING POSITION

SEBI stipulated that the broker-wise outstanding position on any day in respect of carry forward transactions should not exceed 25 percent of a broker's total transactions on that day. This is not a practical proposition. Delivery of securities takes place on the basis of outstanding position at the end of a trading cycle of 14 days and there cannot be any question of working out carry forward business on a daily basis related to the transactions of the day. Jobbing transactions and offsetting transactions due to execution of clients' orders (i.e. purchase or sale of one client in a security being offset by sale or purchase of another client on the same day) get entitled, as per SEBI's stipulation, for carry forward of outstanding positions which they do not need while delivery transactions and speculative transactions not offset cannot be carried to the next day. Certainly, this was not what SEBI had intended. Giving a practical interpretation to SEBI's stipulation, the limits, SEBI presumably had in mind, relate to the outstanding position at the end of the trading period and carry forward to the extent of 25 percent of such outstanding position to the next trading period would be permitted.

The above proposition basically assumes that a stockbroker's house is an amalgam of varied activities relating to stockbroking. This, however, is not so. There is a fairly well-established specialisation into categories such as

brokers dealing with foreign institutional investors and domestic mutual funds, brokers dealing with individual investors, brokers doing business in government securities, brokers undertaking carry forward financing operations, brokers undertaking speculative carry forward positions, brokers specialising in jobbing operations, brokers undertaking odd lot deals, brokers involved in new issues, etc. and multi-operational brokers are not many. To segment each broker-house and to permit a carry forward position of 25 per cent of the outstanding position at the end of the settlement is, therefore, not a workable proposition.

The only limits that are necessary to be imposed in respect of an individual broker should relate to capital adequacy so as to ensure solvency of the contracts. Patel Committee, which had examined this question in depth, had recommended an overall limit of Rs.5 crore with sub-limits of Rs.3 crore of purchase and Rs.3 crore of sales and Rs.50 lakhs in an individual scrip for carry forward business of a broker from one settlement to another. In addition, the Committee had also recommended in respect of speculative transactions an overall limit of Rs.7.5 crore with sub-limits of Rs.4 crore each for purchase and sale and of Rs.1 crore in respect of each scrip outstanding at the close of business on any day within the settlement period of 14 days. A limit of Rs.10 crore per broker had also been recommended in respect of financing carry forward transactions. The Committee had further recommended that a broker's outstanding speculative position and delivery position at any point should be related to the capital adequacy norms of each member in force from time to time. The Committee, however, felt that at an appropriate time later, the question of liberalising these limits could be considered.

In addition to limits on individual stockbrokers, there should be an overall limit on the aggregate outstanding position in a security as a precaution against corners and squeezes and bear raids. These may be fixed at say five percent of the issued capital of the company in a security or say 10 to 15 percent of the floating stocks in the security, whichever is lower. Further, a limit of 10 per cent of the overall limit on the aggregate outstanding position in a security may also be imposed in respect of a broking house so that no single broking house or a conglomeration of them would be able to rig up or hammer down prices.

MARGINS

SEBI'S condition relating to margins at the rates of 20, 30, 40 & 50 percent on positions carried forward at the end of 1st, 2nd, 3rd and 4th and 5th settlements respectively (with compulsory delivery/payment at the end of the 6th settlement) would not only prove to be extremely cumbersome in operation but would also affect adversely liquidity of the market. It is difficult to appreciate the objective behind such a condition. The idea seems to be to induce termination of the contract at the end of the 6th settlement which itself is not necessary.

Rates of margins have to be optimal, not too high as to affect the liquidity of the market nor too low as to endanger the safety of the market. Margins on carry forward positions are like margins on futures in international markets where the rates are generally 7 to 8 percent of the contract value. Since markets abroad are marked to market every day, rates of margins in Indian stock markets have necessarily to be

higher. Patel Committee had, therefore, recommended daily margins at a minimum rate of 15 percent across the board with higher rates for more volatile scrips and the rates of carry over margins to be not less than the rates of daily margins. The Committee had also recommended immediate application of the mark to market principle on a weekly basis to be followed on a daily basis later. In addition, the Committee had also recommended impounding of profits to the extent of 25 percent while fixing the making-up prices. SEBI's stipulation of 20 percent carry over margin could be accepted but there is no need to set up the same for subsequent settlements.

The normal rates of margin are mainly aimed as price protective instruments to act as a cover against likely adverse movement of prices. These are, however, different from price corrective margins where rates can be stepped up to 50 percent or even beyond to be collected on outstanding purchases in a rising market and on outstanding sales in a falling market as the objective is to dissuade purchases in the former case and sales in the latter.

There is a tendency to confuse these margins with the rates of margins in margin trading in the United States where the rates of margin are fixed by the Federal Reserve Board. At present, it is 50 percent which means that a purchaser pays 50 percent of the price and the balance 50 percent is paid by the broker through a 'broker loan' obtained from a bank and collateralised by the purchased stock. Thus, delivery of the stock purchased is taken and full payment made against the same while in the Indian stock markets, difference

between the contract rate and the settlement rate (technically called the making-up price), at which the outstanding transactions are carried forward, are settled.

90 DAYS' STIPULATION

As regards the stipulation by SEBI relating to prohibition on carry forward of a transaction beyond 90 days, it is desirable to know the background of this stipulation and also to consider whether this requirement needs at all to be continued.

When Government of India permitted Bombay, Calcutta, Delhi and Ahmedabad Stock Exchanges in January, 1983 to designate some shares traded as hand delivery contracts as specified shares and to permit the governing boards of these stock exchanges to extend or postpone delivery and payment in respect of contracts in such shares by further periods of 14 days each from the date of the contract so that the overall period did not exceed 90 days from the date of initial contract, the main reason advanced was delays in the banking system and the postal system. Patel committee, which examined this question had opined that "There is no sanctity to limit the performance of the contract to 90 days" as "A contract, which is carried over or renewed with the obligation of the previous contract being fully honoured, is a fresh contract." It is also highly arguable whether a contract once renewed is at all a continuation of the earlier contract, especially so, when the contracting parties in the market change almost completely at the beginning of each settlement and financiers frequently change the scrips depending upon the carry over charges prevailing among the different scrips. It is pertinent to note that the overall limitation

period of 90 days stipulated by Government of India in 1983 appeared to be a device to revive forward trading in shares, keeping in tact the June 27, 1969 ban by Government on "contracts for the clearing". At any rate, this stipulation in practice could not be enforced.

What is desirable, indeed necessary, is not whether or not a contract is performed within 90 days but whether or not a contract, as long as it is alive, is performed. Strict enforcement of this stipulation has the danger of a contract nearing 90 days being ostensibly closed towards the end of 90 days and being re-opened after 90 days with all the attendant risks and without the safeguards like margins, etc. operative in respect of a contract officially carried forward from one settlement to another.

Patel Committee had, however, also recommended that "if it is still intended to retain the overall period of 90 days, the proposal submitted by the Bombay Stock Exchange, viz., each transaction carried over from Settlement No.1 will be identified by a transaction ID and this identification will be continued in every carry over to subsequent settlement without a change in the name of the party to ensure that no transaction is carried beyond Settlement No.6 i.e. 90 days, may be supplemented by a monthly certificate from the panel of Auditors approved by SEBI" in this regard.

SEBI RETRACTS

Happily, although belatedly, SEBI retracted from its earlier impractical propositions and, in its meeting held on October 5, 1995, accepted Patel Committee recommendations with

marginal modifications. While the prescription that no transaction is carried beyond 90 days was retained, auditor's certificate in this regard was dispensed with. Instead, brokers need to give only self certificates. The stipulation relating to publication of the carry forward position of each broker, scrips-wise, before the start of carry forward session has also been done away with. A capital adequacy norm of three percent for individual brokers and six percent for corporates was stipulated and with this, the graded margin system and the limit on the carry forward positions, stipulated by SEBI earlier, were done away with.

RESUMPTION OF TRADING IN SPECIFIED SHARES

Trading in specified shares with the carry forward facility based generally on the scheme recommended by the Patel Committee and duly approved by SEBI resumed at the Bombay Stock Exchange on the historic day of January 15, 1996 after a lapse of over two years.

Although the number of companies in whose equity shares carry forward facility was permitted effective from January 15, 1996 was 94, i.e. the same number prior to the ban imposed by SEBI on December 13, 1993, there have been some changes in the list. Equity shares of nine companies have been deleted and in their place equity shares of an equal number of companies which are now more prominently traded were added. Effective from April 2, 1996, the number of securities in which the carry forward facility is permitted was reduced to 32 which are the most predominantly traded shares. This was done with a view to ensuring that there was no mismatch between volumes and infrastructure. The settlement cycle of 14 days was also reduced to 7 days from March 11, 1996.

Members of the Exchange were given the opting out of the carry forward system. Members were accordingly classified into two categories, viz., Type-I and Type-II. Type-I category consists of members interested in doing carry forward business and Type-II of members not wanting to do carry forward business but would have the facility of doing 'vyaj badla', if they so desire. Initially 248 members out of a total of 545 active members opted to be in Type-I category.

While the BOLT system does not require any separate reporting of transactions, members enjoying the facility of doing carry forward business have to report every day, at the end of normal trading, cumulative position against the six categories of trade as under :

- i) Sales of delivery (SD) : The quantity committed to be delivered in the market at the time of settlement.
- ii) Sales for carry forward (SC) : The quantity which may be carried forward to the next settlement.
- iii) Purchase for delivery (PD) : The quantity for which delivery would be accepted at the time of settlement.
- iv) Purchase for carry forward (PC) : The quantity which may be carried forward to the next settlement.
- v) Vyaj Badla (VB) : The quantity that is carried forward as Vyaj Badla.
- vi) Share Badla (SB) : The quantity that is carried forward as Share Badla.

Each quantity reported under the six categories mentioned above has to be further broken into the six trade categories stated below : i) Own : Trading on member's own account.

ii) Jobbing : Trading for jobbing. iii) FI : Trading on behalf of financial institutions. iv) FII : Trading on behalf of foreign financial institutions. v) MF : Trading on behalf of public mutual funds. vi) Client: Trading on behalf of clients.

A transaction, which is reported as for delivery, must continue as such upto the end of settlement and must result in delivery. A transaction, which is reported as for jobbing or carry forward, can be squared up by an opposite transaction any time or can result in delivery and can also be carried forward upto a period of 75 days and if it is carried forward beyond 75 days, it must result in delivery in the last settlement, i.e., in the settlement after the 75th day. A vyaj badla transaction can not, however, be squared up while a share badla can be squared up any time.

Transactions in the carry forward session are also being conducted on BOLT from 11.30 a.m. to 2.30 p.m. on the Saturday, following the last trading day of the trading cycle normally ending on a Friday.

A few other stock exchanges in the country, including stock exchanges which did not have the facility of trading in specified shares earlier, are expected to commence trading in specified shares in the near future once the switch over to screen based trading takes place which is a condition precedent for trading in specified shares.

CONCLUSION

Markets need instruments for generating liquidity and also for management of risks inherent in a market economy. Most of the markets abroad have a variety of instruments like

futures, options, monthly contracts (which are almost akin to our fortnightly carry forward contracts), margin trading, market making, easy advances against shares, stock lending facilities etc. to provide for these requirements. Trading in futures and options is expected to commence at the National Stock Exchange by the end of 1996. The facility of carry forward, coupled with futures and options, will help in the development of a healthy and orderly growth of the Indian stock market which is poised to be one of the leading markets of the world.

*The views expressed in this booklet are not necessarily
those of the Forum of Free Enterprise*

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

-Eugene Black

FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions and other means as befit a democratic society.

Membership is open to all who agree with the Manifesto of the Forum. Annual Membership fee is Rs.50/- (entrance fee Rs.50/-) and Associate Membership fee Rs.20/- (entrance fee Rs.10/-). Graduate course students can get our booklets and leaflets by becoming Student Associates on payment of Rs.5/- only (no entrance fee).

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