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Financial Intermediaries in Securities Market: An Indian Perspective

Ekta M. Chotaliya[1]
Ph.D. Scholar
Department of Business Management
Saurashtra University
Rajkot, Gujarat – India

Pankaj Trivedi[2]
Associate Professor
K. K. Parekh Commerce College
Saurashtra University
Amreli, Gujarat – India

Abstract: Financial markets in India have grown up and have become complex. They have become more liquid too. Financial reforms since 1991 have resulted in increasing integration of Indian financial system and economy with the global economy. Intermediaries play an indispensable and crucial role in capital market. In this paper we review the meaning and role of intermediary, laws that regulate intermediaries in India, trends in intermediary registration and their code of conduct prescribed by SEBI..

Keywords: Code of conduct, Financial Intermediaries, India, Regulating laws, Securities market.

I. Introduction

Intermediary is the entity that brings the buyers and sellers together and channelizes the resources in the productive way. Some trade transactions require single intermediary while complex transactions require networks of intermediaries at various levels. Functioning of these markets has become complicated by proprietary dealings by intermediaries where the line of difference between investors and intermediaries as discrete market players gets vanished. Efficient financial intermediation channelizes savings and allocates optimally for productive uses. Financial intermediaries provide range of services ranging from traditional brokerage activities to qualitative asset transformation.(Bhattacharya and Thakor) [1993][1]

II. Review of Literature

Edgeworth (1888) proposed that financial intermediaries are efficient producers of liquid assets since there is a diversification in the pool of depositories. Liquidity to an economy may be supplied in two ways: One, directly through trade on capital markets; second, indirectly through financial intermediaries. In the first case, liquidity is created by allowing agents with different cash flow needs to trade among themselves claims on productive assets. In the second case, intermediaries introduce producers and consumers, hold in their portfolio claims on productive assets and issue to individual investors in a secondary market which are tailor made as per their requirement. Dutta and Kapur(1994) studied the role of intermediaries as liquidity suppliers in an overlapping generation structure. Levine (1990) compared allocations obtained with stock market and with financial intermediaries. He found that financial intermediaries improve stock market economy to the extent that transaction costs are present.

III. Market Intermediaries: The Middle Men

When there were closed markets, buyers and sellers used to deal directly to one another and no ‘middleman’ was required. But as and when financial markets expanded and matured, direct dealings were not possible for buyers and sellers. So now capital markets are partially dependent on market intermediaries.

For understanding this dependence and to understand the mechanism how intermediaries are driving the market, it becomes very important to get an insight about who these intermediaries are.

Simply it can be said that market intermediaries bring capital seeker and capital providers together. According to this phenomenon any entity prevailing in the financial market other than the investor and issuer may be called a market intermediary. But the regulatory authority i.e. SEBI (Securities Exchange Board of India) does not give any thorough definition of 'market intermediary'. SEBI (Intermediaries) Regulations, 2008 (thereafter Intermediaries Regulations) defines intermediaries which makes reference to sections 11(2)(b),(ba), and section 12(1),(1A) of the SEBI Act, 1992.[2] As per these regulations, intermediaries incorporate the following:

Stock brokers and sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers, DPs, custodians of securities, credit rating agencies, asset management companies, clearing members, trading members, any other intermediary who may be associated with securities market in any manner.

These regulations clearly exclude foreign institutional investors (FIIs), mutual funds (MFs), foreign venture capital investors, collective investment schemes, venture capital funds from the definition of intermediaries. As only chapter V and VI of the Intermediaries regulations are effective, clause incorporating the definition of intermediaries is only for understanding the regulatory perspective.

In the definition, ambiguity arises in interpreting 'any other intermediary who may be associated with securities market in any manner' because it solely depends on how SEBI interprets 'associated with securities market'. By 'persons associated with market', court would mean everyone who has something to do with the securities market.[3]

IV. Market Intermediaries: Why?

Intermediaries occupy a very imperative space in Indian financial markets. They facilitate proper mobilization of savings into investment. Primarily they match demand and supply.

Economies aim to utilize the resources in a best possible manner. Successful economies generate the opportunities, progress and wealth. Intermediaries help in resource allocation in the best possible and smooth manner. So intermediaries play an important role on the state of economy.

Moreover, today the world has become a global village. Investors and issuers are scattered. Middlemen are required to manage such investors from heterogeneous characteristics.

V. Regulating Laws For Securities Market Intermediaries In India

SEBI has made a detailed regulatory framework for all intermediary categories in the Intermediary regulations. Though only provisions dealing with enforcement orders and procedures are in force and others are yet to be notified. Specific regulations governing various categories of intermediaries are:

The SEBI (stock brokers and sub brokers) Regulations, 1992;the SEBI (merchant bankers) Regulations, 1992; the SEBI (portfolio managers) Regulations, 1993;the SEBI (underwriters) Regulations, 1993;the SEBI (registrar to an issue and share transfer agents) Regulations, 1993;the SEBI (portfolio managers) Regulations, 1993; the SEBI (bankers to an issue) Regulations, 1994;the SEBI (depositories and participants) Regulations, 1996.

These regulations cover the eligibility conditions, registration requirements, continuous compliance requirements, code of conduct, renewal of registrations, investigation, enquiry, maintenance of records, inspection, disciplinary proceedings, adjudication, appeal powers, enforcement orders.

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VI. Code of Conduct

The code of conduct for intermediaries as per SEBI (Intermediaries) Regulations, 2008 covers the major areas as below:

A. Investor protection:

Intermediaries should put their best in order to protect the investors' interest. Investors shall be guided as per their needs in a best possible way by intermediaries. Intermediary shall be responsible for the acts of its employees and agents related to the conduct of its business. Intermediaries shall render the best and high standard of services and shall not act in collusion with other intermediaries in a manner that is harmful for investors.

B. Disbursal of amounts:

Intermediaries shall be quick in disbursing any kind of income received by them on behalf of their investors be it dividend, interest or any such accrual.

C. Disbursal of information:

Intermediaries shall ensure that all the necessary information and disclosures are made to the investors so as to make them well informed decisions. Intermediaries shall also see to it that any kind of communication made by them to investors shall not be misrepresented, misleading or exaggerated. Intermediaries shall keep the records and information pertaining to their client confidential until and unless it is required to be disclosed in compliance with any law for the time being in force.

D. Conflict of interest:

Intermediaries shall avoid conflict of interest and shall put an equitable and non biased mechanism in place in case any conflict of interest arises. Intermediaries shall make fair and true disclosures to the investors so as to provide them fair and unbiased services. Any intermediary or any of its employee or associate shall not indulge in any insider training through their family members, relatives or friends.

E. Compliance and corporate governance:

An intermediary shall ensure that good corporate governance is in practice. It shall not indulge in any fraudulent, unfair or manipulative transactions. It shall never suppress or hide the truth regarding information, reports, papers, etc. when it is to be asked by board or any other authority designated by the board. Any change in the rules and regulations in force which may affect the interest of investors should be made clear to the investors promptly. Intermediaries should have adequate level of competency and knowledge as per the requirement by the board. It shall abide by the act, regulations, circulars and guidelines of the Central Government, the Reserve Bank of India, the board or any other authority related to business carried on by intermediary.

F. Intermediary infrastructure development:

Intermediaries should develop such infrastructure facility in order to deliver its services as an intermediary to the clients / investors in a satisfactory manner. An intermediary shall have the internal procedures and system that can protect their operations, clients, investors, etc. from fraud, theft, misconducts and dishonest activities. Intermediaries should also maintain the records of all the documents so that it can be traced in case of original data loss.

VII. Trends of Intermediaries Registration: A Review

A. Registered intermediaries other than stock brokers and sub-brokers:

From the data it can be seen that apart from 'registrar to issue and share transfer agent' and 'merchant banker', all other intermediaries have shown a minor increase or remained at par with compared to that of in 2011-12.

SEBI intended KYC Registration Agency (KRA) to undertake KYC for all securities market clients. Thus to bring uniformity in the KYC requirements, there are five KRA registered with SEBI as on March 31, 2013.

In order to widen the investor base, to attract the foreign funds and to reduce the market volatility, Qualified Foreign Investors (QFIs) were allowed to directly invest in Indian equity market. They can invest by opening a demat account with SEBI registered DPs having SEBI's prior approval. They are called as Qualified DPs (QDPs). As on March 31, 2013, there are 31 DPs at CDSL and 29 DPs at NSDL having the prior approval to act as QDPs.

TABLE I

(Number)

Type of Intermediary	**2012(As on March 31)**	**2013 (As on March 31)**	**Absolute Variation**	**Percentage Variation**
Registrar to Issue and Share Transfer Agent	74	72	-2	-2.7
Merchant Banker	200	199	-1	-0.5
Underwriter	3	3	0	0.0
DPs-NSDL	287	288	1	0.3
Of which that acts as QDP	NA	29	29	NA
DPs- CDSL	567	577	10	1.8
Of which that acts as QDP	NA	31	31	NA
Credit rating agency	6	6	0	0.0
Bankers to an issue	56	57	1	1.8
Debenture Trustee	32	32	0	0.0
KYC Registration Agency(KRA)	0	5	5	NA

Source: SEBI Annual Report 2012-13.

B. Registered stock brokers:

During 2012-13, 1081 new stock brokers got themselves registered with SEBI in cash segment compared to 256 in 2011-12. The number of cases of cancellation/surrender of membership has been increased to 260 in 2012-13 compared to 184 in 2011-12. As on March 2011-12 and 2012-13 , the number of registered brokers were 9,307 and 10,128 respectively.

TABLE II

(Number)

Details	**2011-12**	**2012-13**
Registered stock brokers in the beginning of the year	9,235	9,307
Addition during the year	256	1,081
Reconciliation/ Cancellation/ Surrender of Membership	184	260
Registered stock brokers as on March 31	9,307	10,128

Source: SEBI Annual Report 2012-13.

C. Registered sub brokers* :

The number of registered brokers has decreased by 9.1 percent from 77,165 as on March 31, 2012 to 70,178 as on March 31, 2013. Though number of Authorised Persons (APs) as approved by stock exchanges in accordance with SEBI Guidelines, has increased substantially during the year (from 98,533 as on March 2012 to 1,25,273 as on March 31, 2013). Investors are able to access the market through APs in addition to sub brokers. APs were encouraged in a SEBI circular dated November 6, 2009 with a view to expand the reach of the markets for exchange traded products. Thus the reach of the exchange traded products in the market has increased although the number of sub brokers has decreased.

TABLE III

Stock Exchange	**2012**		**2013**	
	Number	**Percentage of total**	**Number**	**Percentage of total**
Ahmedabad	81	0.1	77	0.1
Bangalore	158	0.2	158	0.2
Bhubaneswar	16	0.0	14	0.0
BSE	33,852	43.9	31,635	45.1
Calcutta	71	0.1	71	0.1
Cochin	41	0.1	41	0.1
Coimbatore	20	0.0	20	0.0
Delhi	222	0.3	200	0.3
Gauhati	4	0.0	4	0.0
Jaipur	30	0.0	30	0.0

Ludhiyana	28	0.0	21	0.0
Madhya Pradesh	5	0.0	5	0.0
Madras	107	0.1	103	0.1
NSE	42,327	54.9	37,600	53.6
OTCEI	14	0.0	14	0.0
Pune	156	0.2	156	0.2
Uttar Pradesh	3	0.0	2	0.0
Vadodara	29	0.0	27	0.0
Total	**77,164**	**100**	**70,178**	**100**

*As on March 31 of the respective year.

Source: SEBI Annual Report 2012-13.

D. MFs registered with SEBI:

52 mutual funds were registered with SEBI out of which 45 were in the private sector and 7 were in public sector (including UTI) as on March 31, 2013. During 2012-13, PPFAS Mutual Fund, SREI Mutual fund, IIFCL Mutual fund and IL&FS Mutual fund were granted registration. Out of which SREI mutual fund, IIFCL mutual fund and IL&FS mutual fund are dedicated to Infrastructure Debt Fund (IDF).

TABLE IV

(Number)

Sector	**As on March 31,2012**	**As on March 31,2013**
Public sector(including UTI)	5	7
Private Sector	44	45
Total	49	52

Source: SEBI Annual Report 2012-13.

VIII. Conclusion

By reviewing the role that intermediary plays in the financial market, it has been very clear and easy to understand that intermediary performs functions that are vital for smooth, organized functioning and growth of the economy. SEBI has different laws and regulations for different intermediaries. The number of registered stock brokers has increased in 2012-13 compared to 2011-12. As the number of Authorised Persons (APs) increased, the number of registered sub brokers decreased in 2012-13 compared to 2011-12. Though it did not affect the market reach as APs provide the services and market surface to the investors. The number of registered MFs with SEBI has shown a minor increase in 2012-13 compared to 2011-12. SEBI has given an overview of code of conduct for intermediary that is focused on ethical actions and investor protection

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AUTHOR(S) PROFILE

Ekta M. Chotaliya, earned her Bachelor of Business Management degree from Gujarat University in 2009. She received her Master of Business Management in Finance from Gujarat University in 2011. She also got the degree of Diploma in Computer Application from Gujarat University in 2009. She has cleared NET examination in December 2012. In 2013, she joined the doctoral program at Saurashtra University. While pursuing her masters, she has done her summer internship at Emkay Global Financial Servies Ltd. After post graduation, she joined ICICI Securities Ltd. as a relationship manager. At present, she is a PhD scholar at Saurashtra University.