Audit of Members of Stock Exchange

1. Basics

(i) SEBI regulates Stock Exchange.

(ii) Only Members can transact in SE ie Stock Brokers

(iii) ie to say our client cannot trade directly in SE

client $\xrightarrow{a}$ Member $\xrightarrow{b}$ SE

a ---- client Orders member to Sell/Buy

b ---- Members perform the Orders & rem the net proceeds to clients (ie Total proceeds - his Commission)

(iv) Every member should have a DEMAT account to do trading in SE

ie Demat is nothing like ATM card instead of cheque Book

ie Physical shares in Electronic format

Demat A/c's

- Beneficiary A/c
  - Members hold their own Securities Here
- Pool A/c
  - Held on behalf of clients
    - <48 hrs, transfer all securities to client demat a/c

2 Types of Market [SONA]

Spot Market
- Different Settlement periods
- Normal Orders
- Pay in & Pay outs on Same Day ✱

Odd lot Market
- NA
- Normal Orders
- Order Size < Regular lot size
- Price = Quantity
(price & Qty should Tally with each other)

Normal Market
- Regular lot size
- 1 Share = 1 Lot
- ~~Trad~~ Traded in lot size / Multiples of it

Auction Market
- All the above are initiated by Members, but in Auction it is Stock Exchange
- WKT Auction is done when there is any default
- Here, it is due to Shortage / Bad deliveries
- Initiated to complete the Settlement process
- Hur, the Loss is recovered frm Members ☺

✱ Pay In - Broker ⟶ S.E ⟶ towards settlement on a particular day

Pay Out - S.E ⟶ Broker ⟶

"Think frm the view point of S.E"

→ means Transfer of funds.

(5) <u>Margin</u>

- W.K.T, Trading in S.E is similar to Gambling
- There may be profits / Huge losses Generally, we incur Huge losses ☹
- To protect the investor from incurring huge losses due to price fluctuation, "Margin" was introduced
- eg: Assume we had entered into a 6 months forward contract to sell 1000 (1\$ at 44)
  Market rate (closing rate) on that day 41.

  Loss = 4000 (44 − 41) = 3 Rs per \$

- Market rate fluctuates frequently due to the Market forces ie Demand & Supply.
  (As we have read in CPT / PE-1, idc appl)

- Members are Required to keep Margin money with the S.E (clearing House)

- But the same is recovered from client by the member

client → Mbr → S.E

4 Types of Margin [VGM]

<-> **Volatility Margin**

- To curb EXCESSIVE Volatility in Securities.
- To prevent Excess building up of O/s positions
- Calculation:
  - (i) On a particular Security
  - (ii) Applying Specific percentage

<-> **Gross Exposure Margin**

- This is a Minimum Margin that a Member has to keep in S.E ALL THE TIME
- ie % of Net Cumulative O/s position.
- It is calculated on Continuous Basis
- Shd be kept in ADVANCE
- Calculation

$$G.E.M = \% \text{ on } \left(\Sigma \text{ Market value of ALL Securities}\right)$$

<-> **Mark - Market Margin**

- This Margin is imposed to cover the loss on SQUARING OFF the transactions.
- It is a Notional Loss

eg 01/04/2012 - "Call option"

Security	Transacted price	closing price	Profit/Loss
W	1000	800	200
X	2000	1500	500
Y	3000	2200	800
			1500

M-M margin Covers this Loss.

5

Order Matching Rules

(i) Best Buy Order = Best Sell Order

↓ Order with Highest price → ↓ Coz, Seller sells at Highest price

↓ Order with Lowest price → ↓ Buyer @ Lowest price

(ii) Mechanism

The system finds,

Best Selling price to Buyer

Buying to Seller

(iii) $Order_A = Order_B$ => Active Orders

$Order_A \neq Order_B$ => Passive Orders

Ill to c/s, shown at per price/time priority (like FIFO)

6 Order Conditions

- Time Related
- Price Related **
- Quantity Related ***

1 → Day Order – Orders Valid upto ONE day

∞ → Good Till Cancelled – Valid until cancelled by Mbr — NOW this System "NOT AVAIL"

n → Good Till Date/Date Order – Valid until the date specified by Mbr – Now "Not Avail"

Fast Track → Immediate or Cancel order – (Fast Track) ie Buy/Sell as soon as released in System. Bal, if any — Cancelled.

** Price Related Order

- Limited Price Order → Buyer – Max price, I can pay; Seller – Min price, I can sell
- Market Price Order → Market Specifies (ie D×S)
- ## Stop Loss price Order → Release an Order, when the Price reaches the threshold price ie Trigger price → Eg: next Page

eg: Mr Varun Entered into a Contract in a NSE.
I keep my Stop Loss price as "1000"

In Case of

	Call option ie To Buy	Put option ie To sell.
Price when Bought/Sold	Sold at 2500	Bought @ 1500
Market Price	@ 11:15 - 1000 11:20 - 1500 11:58 - 2800	at 11:15AM 800 11:20 500 11:58 200
Decision Time	Buy shares at 11:20 @ 1500. Stop Loss = S.P - C.P = 2500 - 1500 = 1000 STOP LOSS BUY ORDER	My shares will be automaticaly sold at 11:20, when the price reaches Trigger price ie 500 So, as to maintain my Stop Loss = 1000 ie S.P - C.P = Loss 500 - 1500 = (1000) Stop Loss STOP LOSS SELL ORDER

Note: Orders are Stored in Stop Loss Book until the Last Traded Price (LTP) in Market reaches/crosses the Trigger price. Then it is released on Regular lot Book

Note: Trigger price is like B.E.P point

→ Stop loss Buy Order : LTP $\geq$ T.P Buys
sell : LTP $\leq$ T.P . Sells

Quantity Related Conditions

- Disclosed Qty Order
  - ie as much Qty you want to show. When the Qty is released, subsequent Qty is disclosed. (Remember FIFO method)
- Short Sell
  - → Seller sells the shares < a day
  - → ie square up within a day
  - → He can sell the shares, even if he doesn't own them

Summary of Order Conditions

- Time Related
  - Day Order
  - Till date
  - Immediate or Cancel
  - Till Cancelled
- Price Related
  - Limited price
  - Market price
  - Stop Loss price
- Quantity Related
  - Disclosed Qty
  - Short Sell

7 Rolling Settlement

- Trades Outstanding at End of the day are to be Settled within 2 business days from Transaction

- ie T+2 days
ie Transaction Day + 2 days for settlement

- Netting of trades is done Only for the day & NOT for multiple days

- It adopts Value at Risk (VAR) based Margining approach
ie If a member fails to deliver within T+2 day, On the 3rd day, the shortfall is Auctioned.

- eg: Transaction Date = Monday
Hence, Max Settlement Day = ~~T~~ Wednesday

If Settled on Wednesday — Good
If Not, applying VAR — On Thursday it is Auctioned.

Circuit Filters	Circuit Breakers
① It is imposed individual security-wise	① Market-wide
② calculation Based on closing price of previous Trading day	② Based on closing index of last Trading day in a QUARTER
③ SEBI has restricted fluctuations to 10% eg: closing rate - 100 lower freeze - 90 (-10%) upper freeze - 110 (+10%)	③ fluctuations 10%, 15%, 20% Based on index movement & its %, trading is Halted

Circuit Breakers Movement

Index Movement

Time	10%	15%	20%
Before 1PM	1 Hour	2 hr	Remaining
1-2.30 pm	½ Hour	1 hr	Hours of
after 2.30pm	—	Remaining hrs of the day	the day

Note: To halt, Consider the index movement (ie 10% or 15% or 20%) & also the Time

(9) Audit of Accounts

① All ^Active^ members of S.E is required to get the books audited by a CA in practice.

② Active Member = One who has transacted the buz in SE, even for a SINGLE DAY.

(Note: Remember all the books which a member keeps, just do the audit of the same)

① Sauda Book / Daily Transaction Book

- Basic Record
- of All the transactions
- Updated
- Contents

  Rate of securities, Qty, Time, Number, Name of the client.

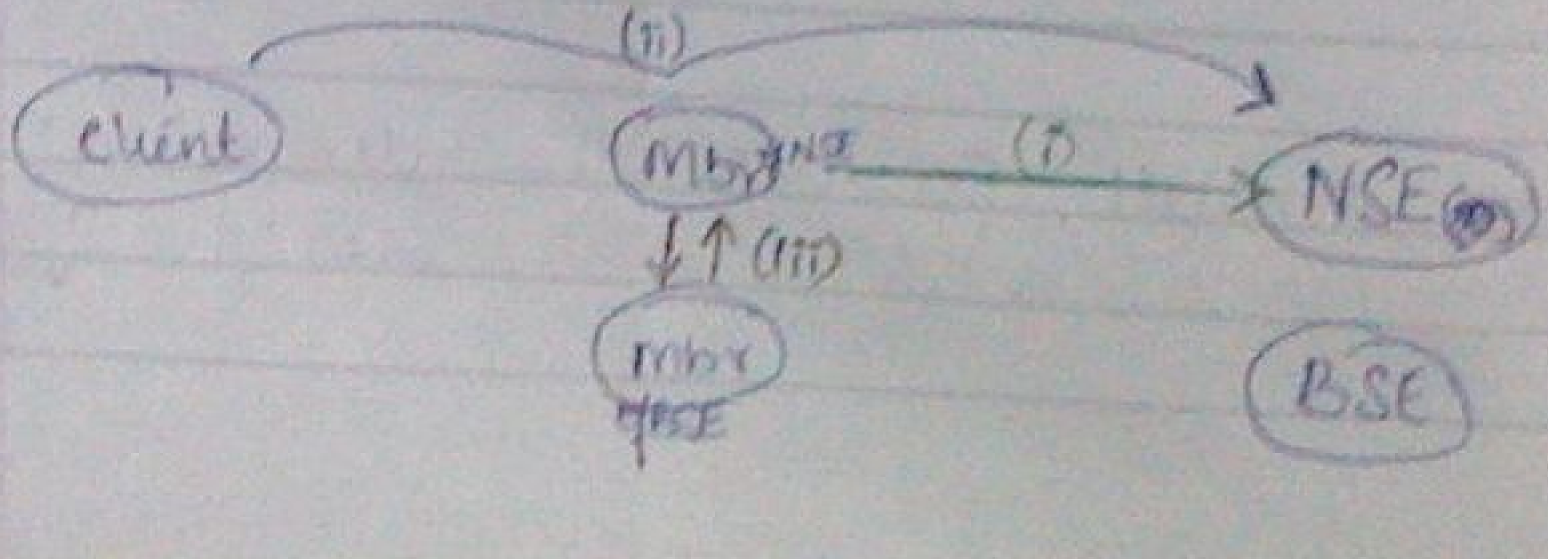
- Add'l Contents

  (i) Mbrs buz with S.E

  (ii) —"— on behalf of client

  (iii) —"— with mbrs of other S.E

  (iv) Spot Transactions.



② Contract Notes

- Just like an agreement b/w client & Member
- Issue CN < 48 hrs of Execution of Transaction
- What things to see?
  - Serially Numbered?
  - Same format, as prescribed by S.E?
  - Brokerage shown seperately?
  - PAN number of Client & Member?
  - Ordering Time & Execution Time?
  - Authorized Signatory?
  - S.T, STT shown Seperately
  - clauses - printed on back side of CN?

③ Margin Deposit Book

already learnt

④ client Bill

- Name, Address of the client
- Net amt payable / Receivable frm client

⑤ client ledger & Clearing Bank A/c

- Each S.E or Segment, seperate Records
- Payable / Receivable, Accounted?
- A/c must be Nil, if not Reconcile
- Since all pay & Receipts are routed thro clearing Housing A/c, the balance in clearing Bank a/c = Bank Balance

⑥ Brokerage A/c

- Shown as Income?
- S.T collected & paid?

(7) Dematerialised Securities

ie Every Mbr to open 2 Demat a/c
ie Beneficiary & Pool.

-

- Sales $\longrightarrow$ Pool a/c (C.H) $\xrightarrow[<48 \text{ hrs}]{}$ client Demat

- Pool a/c ≠ Beneficiary A/c
ie Securities lying in pool account must have not been used to settle members own trade obligations.