

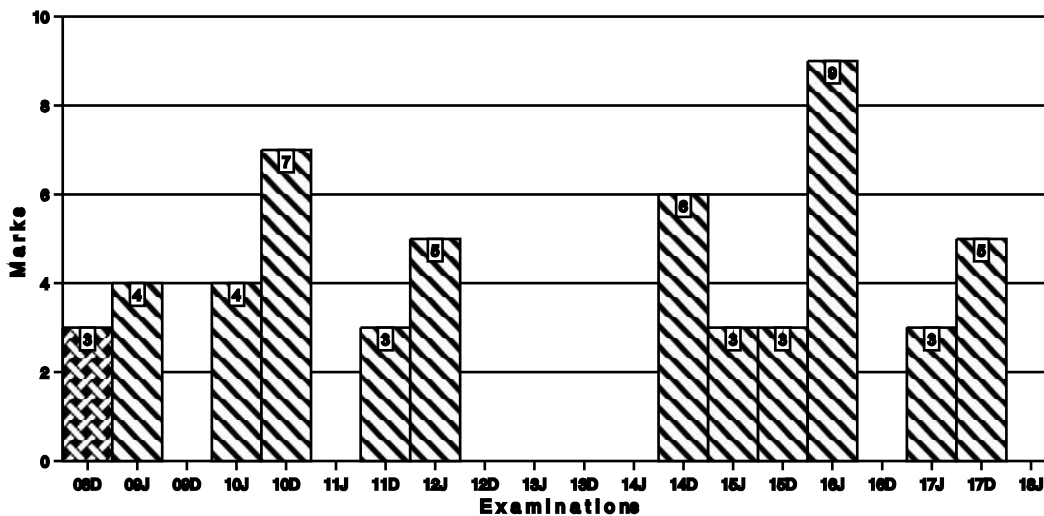
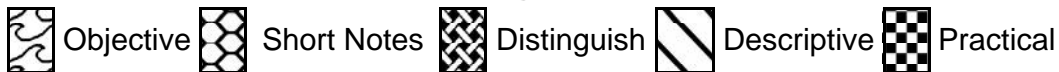
# 1 OVERVIEW OF CAPITAL MARKET

## THIS CHAPTER INCLUDES

- Introduction
- Organisational Structure of Financial System
- Functions of Securities Market
- Securities Market and Economic Growth
- A Profile of Securities Market
- Market Regulations
- Securities Market Reforms and Regulatory Measures to Promote Investor Confidence
- International Organisation of Securities Commission (IOSCO)
- Overview of Depository System in India.

### Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions

#### Legend



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## CHAPTER AT A GLANCE

| Topic                                      | Important Highlight  |
|--|--|
| <b>1. Meaning of Financial System</b>      | <ul style="list-style-type: none"> <li>• A financial system is a set of institutional arrangements through which financial surpluses are mobilised from the units generating surplus income and transferring them to the others in need of them.</li> <li>• The activities include production, distribution, exchange and holding of financial assets/instruments of different kinds by financial institutions, banks and other intermediaries of the market.</li> </ul> |
| <b>2. Constituents of Financial System</b> | <p>Three Constituents of Financial System:</p> <ul style="list-style-type: none"> <li>(i) Financial Market i.e. a facility or channel for movement of funds.</li> <li>(ii) Financial products i.e. shares,</li> <li>(iii) Market participants.</li> </ul>  |
| <b>3. Securities Market</b>                | The Securities Market refers to the markets for those financial instruments/claims/obligations that are commonly and readily transferable by sale.   |
| <b>4. Two types of Securities Market</b>   | The Securities Market has two inter-dependent and inseparable segments, the new issues (primary) market and the stock (secondary) market.  |
| <b>5. Meaning of Primary Market</b>        | The primary market provides the channel for sale of new securities. Simply, in primary market, the securities are sold for the first time. It is also called as New Issue Market (NIM). The issue of securities may be inform of (a) Initial Public Offer (I.P.O.) (b) Further issue of capital (c) Right issue (d) Firm allotment (e) Offer to public (f) Bonus issue.  |

|   |  |
|---|--|
| <b>6. Meaning of Secondary Market</b>             | <p>A market, where previously issued securities are dealt with, so it is called as second hand market.</p> <ul style="list-style-type: none"> <li>• It brings liquidity or free marketability and real price discovery of securities.</li> <li>• Secondary market may be further divided into two parts i.e.             <ol style="list-style-type: none"> <li>(a) <b>Spot Market:</b> Here Securities are traded for immediate delivery and payment.</li> <li>(b) <b>Future Market:</b> Here Securities are traded for future delivery &amp; payment.</li> </ol> </li> </ul> |
| <b>7. Legislation governing Securities Market</b> | <p>The four main legislations governing the securities market are:</p> <ul style="list-style-type: none"> <li>• the SEBI Act, 1992;</li> <li>• the Companies Act, 2013;</li> <li>• the Securities Contracts (Regulation) Act, 1956 and</li> <li>• the Depositories Act, 1996.</li> </ul>   |
| <b>8. Agencies involved in Securities Market</b>  | <ul style="list-style-type: none"> <li>• Ministry of Finance (Finance Ministry)</li> <li>• Ministry of Corporate Affairs (MCA)</li> <li>• Department of Economic Affairs (DEA)</li> <li>• SEBI</li> <li>• Stock-Exchange</li> <li>• RBI</li> </ul>   |
| <b>9. About IOSCO</b>                             | <ul style="list-style-type: none"> <li>• IOSCO: The International Organisation of Securities Commission.</li> <li>• IOSCO, is the worldwide association of national securities regulatory bodies like the Securities &amp; Exchange Commission (SEC) in the USA, the Financial Services Authority in the United Kingdom, and similar authorities.</li> <li>• Today IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95% of the</li> </ul>   |

|                                |   |
|--------------------------------|---|
|                                | <p>world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies.</p>  |
| <b>10. Objective of IOSCO</b>  | <ul style="list-style-type: none"> <li>• Co-operate together to promote high standards of regulation in order to maintain just, efficient and sound markets.</li> <li>• Exchange of information for promoting the development of domestic markets.</li> <li>• Unite their efforts to establish standards and an effective surveillance of international securities transactions.</li> <li>• Provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offences.</li> </ul>  |
| <b>11. Membership in IOSCO</b> | <pre> graph TD     OM[Ordinary Members] --&gt; OM1[Only primary regulators/ regulating authority can be member]     OM1 --&gt; OM2[Having voting right]     OM2 --&gt; OM3[118 Ordinary members]      AM[Associate Members] --&gt; AM1[Any other regulator, except primary regulator can join IOSCO as "Associate Member"]     AM1 --&gt; AM2[No voting right]     AM2 --&gt; AM3[12 Associate members]      AF[Affiliate Members] --&gt; AF1[Stock-exchanges self regulatory organizations can be Affiliate Members]     AF1 --&gt; AF2[No voting right]     AF2 --&gt; AF3[15 Affiliate members] </pre> |
| <b>12. Depository System</b>   | <p>India has adopted the Depository System for securities trading in which book entry is done electronically and no paper is involved.</p>  |
| <b>13. MMoU</b>                | <ul style="list-style-type: none"> <li>• MMoU stands for "Multilateral memorandum of understanding concerning consultation and Co-Operation and Exchange of Information (MMoU).</li> <li>• The MMoU represents a common understanding among its signatories about how they will: <ul style="list-style-type: none"> <li>➤ Consult</li> </ul> </li> </ul>  |

|  |   |
|--|---|
|  | <ul style="list-style-type: none"> <li>➤ Cooperate, and</li> <li>➤ Exchange information for securities regulatory enforcement purposes.</li> <li>● The MMoU itself sets out the specific requirements for what information can be exchanged and how it is to be exchanged.</li> </ul> |
|--|---|

### DISTINGUISH BETWEEN

**2008 - Dec [3]** (a) Distinguish between of the following :

(i) 'Primary market' and 'secondary market'.

**(3 marks)**

**Answer :**

| Basis of Difference     | Primary Market   | Secondary Market  |
|-------------------------|--|---|
| 1. Meaning              | It means a market where resources are mobilized by a company through sale of new securities. | It means a market where existing shares are sold & bought by the investors. |
| 2. Nature of securities | Here shares are first time sold, by the company directly to the investors.                   | Here existing shares are sold by one investor to another investor.          |
| 3. Intermediary         | In primary market there are lots of intermediaries like Merchant Banker, underwriter etc.    | In secondary market there is stock broker, sub broker as intermediary.      |
| 4. Regulated by         | Primary market is mainly regulated by SEBI.  | It is regulated by <b>Securities Contract (Reg.) Act, 1956.</b>             |
| 5. Subdivision          | No such sub division is found.   | It has further two components i.e. Spot Market and Futures Market.          |

**DESCRIPTIVE QUESTIONS**

**2009 - June [5]** (c) Discuss the regulatory framework governing primary market intermediaries. **(4 marks)**

**Answer :**

Primary market intermediary is the intermediary connected to the issue of securities by the issuer company in the primary market. Various market intermediaries involved in the primary markets are Merchant Bankers /lead managers, Registrars and share transfer Agents, Underwriters and Bankers to issue.

These market intermediaries operate under regulatory framework of **SEBI Act, 1992, Securities contracts (Regulation) Act, 1956, Securities Contracts (Rules),1957**. As per **Section 11 to SEBI Act, 1992** it is the duty of SEBI to register and regulate the intermediaries in primary and secondary market. SEBI has also issued regulation in respect to each intermediary to ensure proper service to be rendered by them to the investors and the capital market e.g. SEBI (underwriters) Regulations, **SEBI (Banker to an Issue) Regulations, SEBI (Prohibition of insider Trading) Regulations, 2015**,etc.

SEBI has also issued **SEBI (Intermediaries) Regulation 2008**, to, put in place a comprehensive framework which will apply to the intermediaries. The new regulation provides for all intermediaries to register and regulate the permanent registration, multiple registration form, fit and proper person criteria , suspension and cancellation of certificate of registration.

**2010 - June [3]** (d) "Primary market is of great significance to the economy". Comment. **(4 marks)**

**Answer :**

- Primary market provides channel for sale of new securities and mobilize resources for new projects as well as for existing projects with a view to expansion, modernization, diversification & upgradation.
- The Primary market is of great significance to the economy of a country. It is through the primary market that funds flow for productive purposes from investors to entrepreneurs.

- The latter use the funds for creating new products and rendering services to customers in India & abroad.
- The Strength of the economy of a country is gauged by the activities of the stock exchanges.
- The primary market creates and offers the merchandise for the secondary market.

**2010 - Dec [4]** (c) “A well ‘functioning securities market is conducive to sustained economic growth of a country.” Comment and discuss briefly the regulatory framework of securities market in India. **(7 marks)**

**Answer :**

A well functioning securities market is conducive to sustained economic growth. The securities market fosters economic growth as it (a) augments the quantities of real savings and capital formation from any given level of national income ; (b) increases net capital inflow from abroad; (c) raises the productivity of investment by improving allocation of investible funds; and (d) reduces the cost of capital.

**Regulatory Framework governing Indian Securities Market**

- (I) The following are the **important statutes**, which aim to regulate the Indian Securities market:
  - (a) The Securities Contracts (Regulation) Act, 1956
  - (b) The Securities & Exchange Board of Indian Act, 1992
  - (c) The Reserve Bank of India Act, 1934
  - (d) The Companies Act, 2013
  - (e) The Depositories Act, 1996
  - (f) The Foreign Exchange Management Act, 1999
- (II) The **agencies** involved in regulation of Securities market are :
  - (a) Ministry of finance
  - (b) Ministry of Corporate Affairs (MCA)
  - (c) Department of Economic Affairs
  - (d) The Reserve Bank of India
  - (e) The Securities & Exchange Board of India
  - (f) Stock Exchanges

**2011 - Dec [4]** Comment briefly on the following statement:

- (i) "The securities market has two interdependent and inseparable segments." **(3 marks)**

**Answer :**

The Securities Market has two interdependent and inseparable segments i.e. the new issues (primary) market and the stock (secondary) market.

The Primary market provides the channel for sale of new securities. The issuer of securities sells the securities in the primary market to raise funds for investment and / or to discharge some obligation.

The Secondary market deals in securities previously issued. The secondary market enables those who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs.

**2012 - June [3]** (b) "Securities market enhances the pace of economic growth." Discuss. **(5 marks)**

**Answer :**

A well functioning Securities Market is conducive to sustained economic growth. The securities market fosters economic growth to the extent that it (a) augments the quantities of real savings and capital formation from any given level of national income, (b) increases net capital inflow from abroad, (c) raised the productivity of investment by improving allocation of investible funds , and (d) reduces the cost of capital.

The Securities Market provides a bridge between ultimate savers and ultimate investors and creates the opportunity to put the savings at the disposal of enterprising, thus promising to raise the total level of investment and growth.

**2014 - Dec [2A] (Or)** (ii) What do you understand by IOSCO? Briefly discuss the different membership categories of IOSCO. **(6 marks)**

**Answer :**

- (a) **About IOSCO:** IOSCO stands for "The International Organization of Securities Commission", which was created in 1983 with the decision to change from an Inter-American regional association into a global



cooperative body. Presently, IOSCO is recognized as the international standard setter for securities markets. It provides comprehensive technical assistance to its members.

- (b) **IOSCO Membership:** There are 3 categories of membership with IOSCO which are as:

| Category           | Who can become Member?  |
|--------------------|---|
| Ordinary Category  | <ul style="list-style-type: none"> <li>Membership in this category is open for 'Securities Commission' or a 'Similar Government or Statutory Regulatory Body', that has primary responsibility for securities regulation in its Jurisdiction.</li> <li>Self Regulatory Body, such as stock exchange, if there is no Government or Statutory Regulatory Body.</li> </ul> |
| Associate Category | <ul style="list-style-type: none"> <li>A public regulatory body with jurisdiction in the sub-divisions of a jurisdiction if the national regulatory body is already an ordinary member; and</li> <li>Any other eligible body with an appropriate responsibility for securities regulation.</li> </ul>   |
| Affiliate Category | <ul style="list-style-type: none"> <li>A self-regulatory body (SRO), or</li> <li>An international body, with an appropriate interest in securities regulation.</li> </ul>   |

**2015 - June [2]** Explain the following:

- (d) All securities in the same class are identical and interchangeable.

**(3 marks)**

**Answer :**

The statement that "All securities in the same class are identical and interchangeable" is concerned to one of the key features of the Depository System in India.

**6.10**

■ **Solved Scanner CSEP M-II Paper 6 (2013 - Syllabus)**

The securities held in dematerialized form do not bear any notable feature like distinctive number, folio number or certificate number. Once shares get dematerialized, they lose their identity in terms of share certificate, distinctive numbers and folio numbers. Thus, all securities in the same class are identical and interchangeable. For example, all equity shares in the class of fully paid up shares are interchangeable.

**2015 - Dec [2]** Explain the following:

(a) Primary market is of great significance to the economy of a country.

**(3 marks)**

**Answer:**

The primary market provides the channel for sale of new securities, while the secondary market deals in securities previously issued. The issuer of securities sells the securities in the primary market to raise funds for investment and/or to discharge some obligation.

In other words, the market wherein resources are mobilised by companies through issue of new securities is called the primary market. These resources are required for new projects as well as for existing projects with a view to expansion, modernisation, diversification and upgradation.

The Primary Market (New Issues) is of great significance to the economy of a country. It is through the primary market that funds flow for productive purposes from investors to entrepreneurs. The latter use the funds for creating new products and rendering services to customers in India and abroad. The strength of the economy of a country is gauged by the activities of the Stock Exchanges. The primary market creates and offers the merchandise for the secondary market.

**2016 - June [2A] (Or)** (i) "A well functioning securities market is conducive to sustained economic growth." Explain.

**(5 marks)**

**Answer:**

The given statement i.e. "A well functioning securities market is conducive to sustained economic growth" is correct. This statement highlights the significance of securities market into economic growth. The securities market fosters economic growth to the extent that it:

- (a) augments the quantities of real savings and capital formation from any given level of national income,
- (b) increases net capital inflow from abroad,
- (c) raises the productivity of investment by improving allocation of investible funds, and
- (d) reduces the cost of capital.

**2016 - June [3]** (a) Comment on the following and support your answer with necessary reasons:

- (i) The capital market and the stock exchange in particular are referred to as the barometer of the economy. **(4 marks)**

**Answer:**

- (i) **Nature of Statement:** The given statement i.e. “The capital market and in particular the stock exchange is referred to as the barometer of the economy” is correct.
- (ii) **Reason:**
  - When capital market and in particular stock exchange performs well then it is said the economy of the country is on right track and growing and its opposite is also correct.
  - Government’s policy is so moulded that creation of wealth through products and services is facilitated and surpluses and profits are channelised into productive uses through capital market operations. Reasonable opportunities and protection are afforded by the Government through special measures in the capital market to get new investments from the public and the Institutions and to ensure their liquidity.

**2017 - June [2]** Explain the following:

- (a) Functions of Securities Market

**(3 marks)**

**Answer:**

**Following are important functions of Securities Market:**

- (a) Securities market is a link between investment and savings;
- (b) It mobilizes and channelizes savings;
- (c) It provides liquidity to investors;
- (d) It is a market place for purchase and sale of securities.

**2017 - Dec [2A] (Or)** (iii) What is the eligibility criteria for securing the different categories of membership within IOSCO? Describe. **(5 marks)**

**Answer:**

**(I) Ordinary:**

This category is open to a securities commission, or a similar government or statutory regulatory body that has primary responsibility for securities regulation in its jurisdiction.

If there is no governmental, or statutory, regulatory body in a jurisdiction then a self-regulatory body, such as a stock exchange, in that jurisdiction is eligible for ordinary membership of IOSCO. However, the ordinary membership of a self-regulatory body admitted to IOSCO will lapse if a governmental regulatory body from the same jurisdiction becomes the ordinary member for that jurisdiction.

Ordinary members each have one vote in the Presidents Committee, which meets yearly at the Annual Conference.

**(II) Associate:**

**The following bodies can apply to become associate members of the organization:**

1. A public regulatory body with jurisdiction in the subdivisions of a jurisdiction if the national regulatory body is already an ordinary member; and
2. Any other eligible body with an appropriate responsibility for securities regulation.

A self regulatory body is not eligible for associate membership.

Associate members do not have the right to vote and are also precluded from membership of the IOSCO Board; however, they are members of the Presidents Committee.

**(III) Affiliate:**

A self-regulatory body (SRO), or an international body, with an appropriate interest in securities regulation is eligible for this category of membership.

Affiliate members do not have a vote, are not eligible for the IOSCO Board and are not members of the Presidents Committee. SROs affiliate members form the SRO Consultative Committee.