

# Capital Market: Structure and Emerging Trends

## Part-7

### ▪ **Rolling Settlement: Meaning**

Rolling Settlement is the trading system of securities, in which the transaction (buying or selling of securities) can be squared up by a counter-transaction on the same day only. If the transaction is not squared up on the same day, then the delivery will take up as per the prevailing rules. For example, if an investor purchases a security and the transaction is not squared up by a counter-sale transaction, then this buying transaction must be completed. He will get the delivery and he will have to make the payment for the purchase.

Rolling settlement was introduced by SEBI for the first time in January 2000 in selected scripts. Initially, 10 scripts were brought under rolling settlement. Subsequently on March 8, 2000, 153 more scripts were introduced. By January 2, 2002 all scripts were brought under compulsory rolling mode. Rolling settlement was introduced in the form of T+5 settlement system where “T” is the trade date and ‘5’ is the number of business days after date on which delivery of securities and cash payments are due for settlements. In other words, T+5 means that all open positions at the end of trading date result into delivery and payment five working days after. Gradually this period has been reduced to T + 2 with effect from April 1, 2003.

### • **Advantages of Rolling Settlement system:**

1. One, it reduces speculation and arbitrage in scripts as settlement occurs on a daily basis. Thus, there would be increase in delivery-based transactions reducing the speculation currently existing by way of carry forward of position in various scripts. Apart from this, shifting position from one stock exchange to another will reduce which; in turn will eliminate arbitrage opportunities in scripts.
2. Two, it reduces pricing glitches and manipulation and explores a better price discovery process. With the rolling settlement in place, all open positions at the end of each day would come up for delivery thereby improving the quality of cash market transactions. Thus, price formation process on daily basis would be improved thereby resulting in improved price discovery process.
3. Three, it reduces end of settlement period pressure as shares are delivered and cash is paid everyday instead of a week. Thus, the rolling settlement spreads the delivery and payment throughout the week.

4. Four, it narrows the bid-ask spreads, reduces the settlement risk and eliminates the need to synchronize the settlement dates on NSE and BSE or for that matter across the exchange.
5. With the implementation of a rolling settlement system, investors will be benefited, as settlement will not take long and the prices an investor pays or receives will be closer to the market price. Securities and money will be transmutable.

### ▪ **Credit Rating**

**Meaning:** Credit rating is an analysis of the credit risks associated with a financial instrument or a financial entity. It is a rating given to a particular entity based on the credentials and the extent to which the financial statements of the entity are sound, in terms of borrowing and lending that has been done in the past.

**Description:** Usually, is in the form of a detailed report based on the financial history of borrowing or lending and credit worthiness of the entity or the person obtained from the statements of its assets and liabilities with an aim to determine their ability to meet the debt obligations. It helps in assessment of the solvency of the particular entity. These ratings based on detailed analysis are published by various credit rating agencies like Standard & Poor's, Moody's Investors Service, and ICRA, to name a few.

### • **Credit Rating Agencies**

Credit rating agencies are agencies which provide ratings to represent objective analyses and independent assessments of companies, entities or countries that issue such debt securities. These ratings are an indication to the buyers of this debt how likely they are to be paid back.

### • **Functions of a Credit Rating Agency**

1. Compiling financial data essential for loan decisions and insurance.
2. Statistical assessment that is involved in ascribing a rating to a borrower.
3. Providing investors an objective analysis of the organization's ability to pay back.

- **Importance of Credit Ratings**

### For The Money Lenders

1. **Better Investment Decision:** No bank or money lender companies would like to give money to a risky customer. With credit rating, they get an idea about the credit worthiness of an individual or company (who is borrowing the money) and the risk factor attached with them. By evaluating this, they can make a better investment decision.
2. **Safety Assured:** High credit rating means an assurance about the safety of the money and that it will be paid back with interest on time.

### For Borrowers

1. **Easy Loan Approval:** With high credit rating, you will be seen as low/no risk customer. Therefore, banks will approve your loan application easily.
2. **Considerate Rate of Interest:** You must be aware of the fact every bank offers loan at a particular range of interest rates. One of the major factors that determine the rate of interest on the loan you take is your credit history. Higher the credit rating, lower will the rate of interest.

- **A brief overview of Indian Agencies**

Rating Agency	Significance
CRISIL	CRISIL (“Credit Rating Information Services of India Limited”) is the largest rating agency in India with over 65% of Indian market share. Established in 1987, it has been offering its services in manufacturing, service, financial and SME sectors. Standard & Poor’s now holds the majority stake in CRISIL.
CARE	CARE (“Credit Analysis and Research Limited”), established in 1993 is a credit rating agency promoted and backed by IDBI, UTI, Canara Bank, and other financial institutions and NBFCs. Ratings provided by CARE include financial organizations, state governments and municipal entities, public utilities and special purpose

	vehicles.
ICRA	ICRA, backed by Moody's is a leading agency that focuses on rating corporate governance, Mutual funds, hospitals, infrastructure development and construction and real estate companies.
SMERA	SMERA, a joint venture by several learning banks of the country primarily focuses on rating the Indian MSME segment.
ONICRA	ONICRA is a private rating established by Mr. Sonu Mirchandani which analyzes data and provides rating solutions for Individuals and Small and Medium Enterprises (SMEs). It has credible experience in operating across sectors like Finance, Accounting, Back-end Management, Application Processing, Analytics, and Customer Relations.

### ▪ Securities Lending Scheme

Stock lending or borrowing (SLB) is a system in which traders borrow shares that they do not already own, or lend the stocks that they own but do not intend to sell immediately. It involves a lending institution who lends its assets-securities to another party, the borrower, who needs the security for delivery to clients or other brokers to avoid a failed delivery.

In India, SEBI has approved a Securities Lending Scheme with effect from February 6, 1997 and thereafter the securities lending and borrowing can be undertaken only by approved intermediaries. The securities borrowing and lending defined as lending of securities through an approved intermediary to a borrower under an agreement for a specified period with the condition that the borrower will return equivalent securities of the same type or class at the end of the specified period along with the corporate benefits accruing on the securities including dividends, right, bonus, redemption benefits or any other such right accruing on the securities lent.

- **Features of Securities lending and borrowing (SLB) scheme**

- Automated screen based trading platform with online matching of trades based on price- time priority.
- Tenure of lending and borrowing available up to a period of 12 months.
- A facility for placing early recall request for the securities lent is provided to the lender.
- A facility for the borrower to make an early repayment of securities and further relend them.
- The transactions are based on fixed monthly tenures with specified reverse leg settlement dates and the tenure ranges from 1 month up to 12 months.
- Transactions carried out under SLB segment are guaranteed by Clearing Corporations and hence do not carry any counter party risk.
- The specified **reverse leg settlement**\* date is the first Thursday of the corresponding month. Each reverse leg settlement date is assigned a specific series number. Majorly securities traded in F&O segment are eligible for lending & borrowing under the scheme.

\*"Stock Return Day" is the reverse leg settlement date, which means the day on which the Borrower will return the securities to the Lender and the contract will come to an end.

- **Benefits for Lenders**

- 1) Lenders can earn additional income from the idle portfolio held as they receive a certain fee to lend the stock, depending upon the demand and time value.
- 2) There is no limitation of minimum quantity that a lender could lend.
- 3) Lenders are entitled for all the corporate action like dividend, bonus etc. that takes place during the lending period.
- 4) No counter party risk as all the transactions are guaranteed by the Clearing Corporations.

- **Benefits for Borrowers**

- 1) Borrowers can carry out short selling of securities, which are not available in derivatives segment (once the borrowing is done from SLB segment).
- 2) SLB enables borrowers to meet the obligation in case of shortage in delivery and avoid an auction (seller shortage) in Cash segment.

3) SLB enables arbitrage opportunity for borrowers if there is price difference in the Cash and Derivatives market.

4) SLB enables borrowers to meet the obligation arising out of physical settlement under the derivatives segment.

SLB thus is a prudent way for investors to make an additional income by lending their idle stocks at a certain fee, for stipulate duration. Traders, on the other hand, can borrow the stocks and can then benefit from arbitrage opportunity or meet the exchange obligation of pay-in of stocks.