Working Paper

BADLA TRADING: A PRIMER AND A PROPOSAL

By

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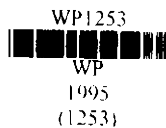
W P No.1253
May 1995


WP1253
WP
1995
(1253)

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AHMEDABAD - 380 015
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BADLA TRADING: A PRIMER AND A PROPOSAL

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ABSTRACT

This paper explains the mechanics of badla trading and settlement. It reviews badla transactions, fixation of havala rates and margins, the market process of determining the badla rates, and payment procedures. The accounting mechanism for carry over business is illustrated with hypothetical transactions in a 'valan'. An evaluation of risk-return in carry over business and badla financing is done.

The author reviews the deficiencies in existing practices followed by the Stock Exchange authorities in fixing havala rates and margins; and general enforcement of rules related to carry over business. Certain suggestions regarding simplification of margin fixation and collections are made. In the absence of institutional arrangements for margin trading and short selling, SEBI is urged to reintroduce badla system but only after making sure that the Stock Exchange Authorities would behave in a responsible manner and have proper wherewithal to ensure effective monitoring. Stock Exchanges as a Self-regulatory Organizations (SROs) would have to devise effective systems which are not prone to unwarranted influences. Specific suggestions for Stock Exchange authorities are :

a) Do not make compromises in fixing havala rates to solve temporary default problems;

b) Collect margins at a fixed percentage (say 35 per cent) of the gross value of total carry over business; do not fix varying margins for bulls and bears for different scrips.

c) Closely monitor and prohibit practices used by brokers such as 'vandhas' and 'chalu upla' to reduce margin liabilities.

d) Limit carry over business to 12.5 times of the broker's net capital. Insist on segregation of clients' deposits from broker's capital. Enforce capital adequacy norms stringently.

Hopefully, with the change in power equation between Executive Director and the member brokers on the one hand and composition of the Governing Board on the other, it should be possible for SEA to ensure necessary control and monitoring system for successful operation of badla system.

BADLA TRADING: A PRIMER AND A PROPOSAL

Forward trading in India was banned by the Government of India on June 27,1969. However, to provide liquidity, continuity and direction to the market, the Stock Exchange authorities in four stock exchanges (viz., Ahmedabad, Bombay, Calcutta, and Delhi) placed certain securities, out of those listed, on the so- called Specified List in which margin trading became possible. In these specified securities, it was not necessary that transactions entered during a "valan" (trading period) be settled by delivery and payment made at the end of the trading period. Unsettled transactions were allowed to be carried forward from one settlement to the next on a badla basis.

However, this carry over system of trading (widely known as badla market) fell in disrepute mainly because of a faulty implementation and monitoring system. There were frequent payment crises and settlement delays. There was a lack of transparency in trade and full reporting of transactions. Margins were low and were not collected on total outstanding business. Stock Exchanges were functioning as a closed club of brokers, ignoring interests of the general investing public. As a result, SEBI had to intervene to check unethical and crisis-prone practices and instruct Stock Exchanges to abolish badla system by March 1994. SEBI was hoping that an internationally accepted system of options and futures trading would replace the indigenously evolved badla system. However, given our legal, banking and financial infrastructural constraints, alternate system of forward trading could not be evolved. A major constraint is the absence of facilities for margin trading and short selling. Regulators and financial community are having a second look at the badla system. This paper is an attempt to explain the mechanics of badla trading and settlement system.

Badla Trading

To facilitate carry-over trading, securities listed on the four stock exchanges (i.e., Ahmedabad, Bombay, Calcutta and Delhi) were divided into two categories called: 1) Specified securities and 2) Cash group securities. The Specified securities were also known as Forward securities, Cleared securities or "A" group securities. Similarly, Cash securities were also known as Non-cleared securities, Non-specified securities or "B" group securities. There were 94 securities traded as specified securities on Bombay, 50 on Calcutta, 43 on Delhi and 21 on Ahmedabad stock exchanges. With 45 securities common in the

specified list of these four stock exchanges, the number of securities in which this type of trading was being done across four Stock Exchanges was 136.

The classification into specified and Cash groups was determined by the Governing Board of the Stock Exchanges on the basis of me of trading, liquidity, size of the equity base, and more importantly the distribution of securities among investors. Additionally, to qualify as a Specified security, the particular security should be fully paid-up equity share and should have been listed on a recognized stock exchange for at least three years.

The major difference between the Specified and the Cash group was in the terms of settlement. Transactions in the Specified securities were settled among member brokers of the Stock Exchange through the clearing house attached to the Stock Ex change while the transactions in the Cash group were settled between the members themselves. For settlement in cash securities, it was compulsory to make the payment for the shares bought and tender delivery of the shares sold on the day of settlement. In the case of specified shares, however, tendering the delivery of shares sold and accepting the delivery of shares purchased was not compulsory. On mutual agreement with the counter party to a transaction, it was possible for a broker to carry forward the outstanding business from one settlement period to the next through a mechanism called badla trading.

Settlements in Badla Trading

For a given settlement, trading in securities is restricted to specified time periods called settlement periods. These were normally of a fortnight's duration and ended on alternate Fri days. All transactions in the specified securities entered into by a broker in a given settlement period had to be settled and the accounts cleared in that period itself in one of the following ways :

a) By taking delivery of shares and making payments for the bought position, or making delivery and receiving payment for the sold position. The delivery and payments were done through a clearing house at Make-up prices (explained later). The difference between make-up prices and actual transacted prices are settled between brokers directly. The investor client receives (or pays) the price (inclusive of brokers' commission) of the transaction from (or to) his broker.

b) By squaring the transaction during the settlement period itself, leaving no outstanding position at the end of the settlement period, and the investor merely collects (or pays) the difference between prices at which shares were sold and bought.

c) By carrying forward the transaction at Make-up (or havala) prices to the next settlement period. (How a transaction is carried forward is explained below)

Make-up prices

Outstanding transactions at the end of a settlement period were carried forward through the clearing house at Make-up prices. This make-up price or havala rate for a security was fixed by the Stock Exchange authorities. The make-up price was normally the rounded figure of the closing quotation of the shares on the last trading day of the settlement period.

However, on certain occasions when the Stock Exchange authorities had reasons to believe that a deliberate attempt was made to influence the closing price, they may decide to fix a make-up price different from the closing quotation of the last day. Often such an action was taken with an intention of avoiding payments problems in the next settlement period as a result of unusually high or low closing prices. The make-up price to be declared was decided upon by considering the price levels at which most of the transactions had been done and also the level to which the prices may fall in the next period so that the threat of payment problems was minimized. Such occasions arose only when there was a sudden fall in an oversold market or in crease in an overbought market. For example, in 1992 just after the budget presentation, price of Reliance share jumped from Rs. 200 to Rs. 330 which was an unusual increase, The Stock Exchange authorities felt that this increase was sudden and could not be sustained, so the Ahmedabad Stock Exchange (ASE) board decided to keep the make-up price for Reliance at Rs. 225 for this settlement period. It may also be pointed out here that on many occasions, a coterie of powerful brokers would manipulate fixing up havala rates to suit their interests (like minimizing immediate cash payments) and thus put the entire system on unwarranted risk.

The Make-up prices had two very important functions. First, they were used to close the books for the current trading period on the settlement date and open the books for the

next settlement period after adjusting for the carry forward charges. The mechanism of carrying forward is dealt with later.

Second, Make-up prices were used by the Clearing house of the Stock Exchange for receiving payments from the members for their purchases and making payments to the members for their deliveries. In this process, some brokers receive less (or more) than what is actually due to (or from) them. The differences between transacted price and make-up price (known as standard differences) were settled directly between the members and normally constituted relatively small amounts as compared to the total volume of payments and receipts. This is illustrated in the following example.

Suppose broker A buys 100 shares of a company at Rs. 65 per share from broker B and 100 shares at Rs. 80 from broker C during a settlement period. Suppose that on the settlement date the make up price is Rs. 75 per share and A wants delivery of the shares. In this case, 200 shares would be delivered to A by the clearing house against a payment of Rs. 15000 at the rate of Rs. 75 per share, i.e., at the Make-up price. Broker B and C would deliver 100 shares each to the clearing house and receive Rs. 7500 each, again at the rate of Make-up price. The difference between the actual price of Rs. 65 and make-up price of Rs. 75 would be paid by B to A. Similarly, A would pay the excess of transacted price over the make-up price, i.e., Rs. 5 per share to C as A has bought the shares at Rs. 80 from C. Thus, B would pay Rs. 1000 to A and A would pay Rs. 500 to C to settle the accounts completely.

Badla Transactions

The total number of shares bought in the market during the settlement period has to be equal to the number of total number of shares sold in the market. If there are net outstanding bought positions in the market, there have to be net outstanding sold positions of an equal number of shares as well. If buyers, having net outstanding bought position on the settlement date wish to defer the settlement of their positions to the next settlement date, they would have to find corresponding sellers who have outstanding sold positions and are willing to carry forward their positions.

It should be understood that even in cleared securities, delivery and payment are compulsory as far as outstanding business of the broker is concerned. All accounts have to be closed for the current settlement. Only if buyers/sellers find other sellers/buyers who are willing to participate in the carry for ward transactions can these transactions be effected, else, the buyers/sellers have to fulfill their contracts or face auctioning of their position.

It should be appreciated that a substantial proportion of transactions in Specified securities used to be speculative. Most of the sellers sold short i.e., they did not possess the shares at the time of sale and expected to cover up the sale by buying at a future date. Hence, if called upon to deliver, they had to buy the shares in the market or borrow them from someone to cover the short sale. The buyers too, did not buy shares with the intention of investing but for making speculative gains. They were usually not willing to take delivery of the shares bought. If called upon by the sellers to take delivery, either they had to part with their own funds or arrange for finances from other sources to fulfill their purchase contracts. This nature of interdependence between the buyers and sellers is the guiding force in carry forward trade.

The Fixing of Badla Rates

If a broker wants to carry forward, say, his client's outstanding bought position, he would have to find another broker who has an outstanding sold position and is willing to carry forward his transaction. In case of failure to find a counter part, he would be forced to take delivery of the shares. However, in such a situation, a broker can arrange for a **budliwalla** or **financier** who would take delivery of these shares instead of the client. In either case the process is called forwardation and the client pays a charge called the contango or seeda badla. In the former case, the charge would change hands through the brokers and reach the seller of the shares. In the latter case, the charge accrues to the financier through the broker.

Contango is basically an interest charged on the principal that the seller or the financier is providing the buyer. The seller, in agreeing to carry forward the transaction by deferring the receipt of payment, is effectively lending funds to the buyer for the duration upto the next settlement period. In case of financier, the lending of funds is direct and not

implied. The rate of interest depends on many factors such as demand and supply for such scrips i.e., whether the market is overbought or oversold, the money market situation etc. The badla charges are negotiated in a manner similar to share prices by "open cry" during the badla session which lasts for 30 minutes. Here badla rate negotiation is for the facility to carry forward the settlement to the next period and thus gaining additional time for settling the outstanding business. This session is fixed after the end of the current trading period (valan) and before the beginning of the next trading period. During this session, like a stock market open cry system, the transactions take place where brokers bargain for rates of carry forward.

The badla rate varies from one deal to another as also from one security to the other in the same settlement period and across periods for the same security. This price depends upon a constantly varying set of factors like extent of outstanding position, floating stocks, returns available in alternative channels of investment, ready availability of finance, extent of short sale etc. The short sale, contrary to general belief, actually acts as a balancing factor in the determination of 'badla' rates. In some stock exchanges such as Ahmedabad, at the end of badla trading session, a weighted average rate is calculated for each security based on the volume of the transactions carried during the session and this rate is used as the contango or backwards charge for all carried forward contracts that were entered into between the brokers before the trading period on the settlement date had begun.

At times, the number of buyers demanding deliveries may exceed the number of sellers capable of making deliveries. This could be because the sellers, who sold short, are unable to find shares in the market to cover their short sales. In such a case, the market is said to be in oversold position. In an oversold market, the seller's broker would arrange for a lender who can provide shares for delivery. This may not be easy as stocks are not often readily available. To persuade the buyer to carry over the outstanding business, the seller would have to pay a charge called backwardation or undha badla. The backwardation charge is basically a penalty imposed on the seller for overselling.

Book Entries

On forwardation, the buyer is deemed to have sold the out standing shares at the making up price and the books for the current settlement period are closed by this entry. At the same time, the books for the next settlement period are opened by a contra entry whereby the buyer is deemed to have bought the previously outstanding number of shares at the making up price plus the contango or badla charge. A similar scheme of book entries would be executed for the seller who would be deemed to have bought the shares at the making up price on the settlement date and sold the shares at the making up price plus the contango at the beginning of the next period. For undha badla, the book entries are similar to those in contango except that the opening entries for the next period are for transactions deemed to have been executed at the making up price less the backwardation charge or undha badla. The mechanism of book entries is illustrated below.

Say, Aditya put through the following four transactions through his broker Jatin Chokshi, a member of Ahmedabad Stock Exchange (ASE) during the current valan ending 7th June. Bought 100 TISCO shares at Rs. 245, bought 200 Arvind shares at Rs. 150, sold 100 Arvind shares at Rs. 155 and sold Atul 50 shares at Rs. 115 net. The prices are net i.e., inclusive of brokerage charges. Badla was to take place on 8th June at noon. ASE announced the following havala rates - Arvind Rs. 145, TISCO Rs. 240 and Atul Rs. 110. ASE also announced the following margin rates on out standing position - TISCO Rs. 20 for bulls, Rs. 12 for bears; Arvind Rs. 12 for bulls and Rs. 8 for bears; and Atul Rs. 10 for bulls, Rs. 6 for bears. On 8th June in Badla Session, badla rates were negotiated and as per practice, ASE announced Rs. 3.00 for TISCO, Rs. 2.40 for Arvind and Rs. 1.60 for Atul as the badla rates. The broker, Jatin Chokshi, has agreed to carry forward Aditya's outstanding positions, provided that Aditya pays him the amount due for the current valan. Jatin also charges 15 per cent commission on badla rates for doing badla transactions. Next settlement date is 21st June i.e., next valan would be of 14 days' duration.

Given the above facts, a number of questions can be asked. First, how much cash would Aditya have to pay for this settlement. Second, what are his costs of carrying forward the transactions in each security. Third, what are the risks he is taking.

To find out how much money Aditya would owe (receive) to (from) broker, one would have to calculate the standard difference (i.e., difference between transacted price and the havala rate) on outstanding position, profits earned on completed trans actions, and the margin money to be deposited with ASE for carrying forward the transactions. However, these calculations need not be done separately. For each valan, the broker prepares for each client an accounting statement incorporating all the above. Following is a statement for Aditya's trading in the current valan. Positive sign (+) indicates amounts owed by the broker to Aditya, and negative sign (-) indicates amounts owed to the broker by Aditya.

	(Rupees)
Actual Transactions:	
Bought TISCO 100 shares @ 245	- 24500
Bought Arvind 200 shares @ 150	- 30000
Bought Arvind 100 shares @ 155	+ 15500
Sold Atul 50 shares @ 115	+ 5750
	- 33250
Carried Forward Transactions at Havala Rates:	
Net bought position TISCO 100 shares @ 240	+ 24000
Net bought position Arvind 100 shares @ 145	+ 14500
Net sold position Atul 50 shares @ 110	- 5500
	+ 33000
Margin money to be deposited with ASE:	
TISCO 100 shares @ 20 (margin for bull)	- 2000
Arvind 100 shares @ 12 (margin for bull)	- 1200
Atul 50 shares @ 6 (margin for bear)	- 300
Total Margin Money	- 3500

Thus, total amount to be received by the broker is -33250+33000-3500 which is equal to Rs. 3750. As explained earlier, this includes standard differences, profits earned (losses incurred) on completed transactions and margin money to be paid.

The accounting practice may be different in other exchanges which may follow a practice of fixing two havala rates- one for bulls (i.e., who have a bought position) and the other for bears (i.e., who have a sold position). For bulls the havala rate would be lower (i.e., the central rate minus margins for bulls) and for bears it would be higher (i.e., the central rate plus mar gins for bear). To illustrate, in our above example, havala rate for bulls in Arvind would be Rs. 133 (i.e., Rs. 145-12) and for bears Rs. 153 (Rs. 145+8). However, the amounts payable by the transacting parties will be the same under both systems.

In the accounting statement for this valan, we did not have any entries brought forward from a previous valan, as this was a new account. However, for the next valan, the accounting statement would include the following entries for carried forward business from the valan which ended on June 8. The opening entries would be the following :

Opening entries as a result of carried forward business

TISCO 100 shares @ 243.45	- 24345
Arvind 100 shares @ 147.76	- 14776
Atul 50 shares @ 111.36	+ 5568
Margin Deposit with ASE	+ 3500

The opening rate i.e., Rs. 243.45 per share for TISCO includes Rs. 240 havala rate, Rs. 3.00 badla rate and Rs. 0.45 brokerage for broker on badla transaction. Similarly, for Arvind these figures are Rs. 145, Rs. 2.40, and Rs. 0.36 respectively. In case of Atul there is a credit entry @ 111.36 per share which includes, Rs. 110 for havala rate, receipt of Rs. 1.60 as badla charges and payment of 0.24 as brokerage commission on badla transaction.

The second question was what are his carrying costs for each security and for the valan as a whole. To determine this, first compute the additional funds required to settle the transaction in the current period itself and the badla cost (inclusive of brokerage) incurred to carry forward the transaction. The additional funds needed to settle the transaction in TISCO is Rs. 220 (Rs. 240 havala rate minus Rs. 20 deposited as margin) and the badla cost is Rs. 3.45 (inclusive of broker's commission). The badla charges are for a period of 14 days. The monthly cost of carrying forward of transaction would be 3.36%. Similarly, for Arvind figures would be Rs. 133 and Rs. 2.76 giving a monthly rate of 4.44%. For Atul, calculations would be slightly different. If Aditya made delivery, he would have received Rs. 110 (havala rate), but to carry forward the transaction, he has to pay Rs. 6 as margin money; thus, total funds locked up are Rs. 116 per share and the badla receipts are Rs. 1.36 (i.e., Rs. 1.60 minus 15 % broker's commission). This gives a monthly figure of 2.51%. Thus, the cost of carrying forward the transactions are 3.36% for TISCO and 4.44% for Arvind. On short sale of Atul, there is an income of 2.51 % per month.

One may point out here that Aditya is not bound to carry forward the entire net outstanding position in a scrip to the next valan. For example, in TISCO his net bought position is 100 shares. If he chooses, he can take delivery of 50 shares by paying additional money at the havala rate (difference between transacted price and havala rate has to be settled anyway, irrespective of his choice to carry forward or not) and carry forward his position in the remaining 50 shares. If he does that, he would have to pay margin only on 50 shares and not on 100 shares. The additional funds required for taking delivery would be @ Rs. 220 per share i.e., Rs. 240 (havala rate) minus Rs. 20 (margin for bull) for 50 shares. I may repeat here that this carry for ward of all or part of the transactions is possible only when there is a counterparty in the market who is willing to temporarily (i.e., for the period upto next settlement) take over the purchases (i..e, finance the purchase).

Risks in Carry-over business

The third question in the example is what are the risks involved in carrying forward the transactions. First is the risk of extension of the duration of next valan. If this happens, computed monthly returns on badla transactions would not be realized. Normally, a valan

is of 2 weeks' duration, but on Indian Stock Exchanges, it is not uncommon to extend the valan to suit the brokers' needs or, due to ineptitude and bad management of the Stock Exchange authorities, to complete the settlement procedure in time. There are a number of steps involved in completing a settlement. These steps include submission of Sauda sheets, changes/objections memos to match net outstanding positions among brokers, issue of Delivery Order (Form No. 19-20A), Pay-in-Day, Pay-out-Day etc. All these formalities have to be completed before the end of the next trading period.

The second kind of risk is whether a carried over contract would be performed in the next period. To guarantee the performance of a contract, Stock Exchanges do collect the margin, but margins are very low compared to the fluctuations noticed in prices of "A" Group securities. There is also no objective way of setting these margins. As the practice was prevalent, Stock Exchange Authorities would normally gauge the stock market position (i.e., whether it is oversold or overbought) and accordingly fix different margins for bulls and bears. Further, these margins as percentage of havala rates would vary considerably from scrip to scrip and from one period to another. Moreover, these margins as a percentage of havala rates were so low that they allow considerable leverages to the extent of 10 to 20 times of owner's funds, putting the entire system on a roller-coaster. Added to this there are problems of not reporting the complete outstanding positions by collusion with other member brokers and, thus, avoiding substantial amount of margins. Given all this, performance guarantee of the contract in the next settlement is elusive. A considerable improvement in margin collection by Exchange Authorities is a must for successful operation of badla system.

Considering these problems, the SEBI in March 1994 decided to ban the badla system. However, in practice, the badla market shifted to the informal market. The modus operandi remained the same, except that financing of badla transactions now are kept out of books of accounts. Normally, brokers borrow these funds from investors who have surplus money to invest (in the Indian economy, major badla financiers were and are doctors, lawyers, builders, jewelers etc.). Earlier, the financiers would get the market determined badla rates and would also receive the delivered shares as a security for lending the money to finance somebody else's purchases. But now, since the badla is officially

banned, brokers borrow money at fixed interest rates, much lower than what they earn in so-called renewal transactions. Since renewal of transactions is not recognized by the Stock Exchanges, the entire process is unofficial and therefore, riskier. Thus, the returns to financier have decreased and the risk has in creased. The only beneficiaries have been brokers.

Renewal is a mechanism to postpone the settlement of trans actions at closing prices without any apparent consideration. One commonly advanced reason for renewals is non-receipt of share certificates from up-country clients. Renewals are normally in Cash group securities, as business in the Specified securities is monitored much more closely. With the ban on badla, considerable business has shifted from Specified group (A group) securities to Cash group (B groups) securities. As compared to the last six years (see table) the turnover figures on Bombay Stock Exchange (BSE) for the ten months of the current year to January 1995 clearly depicts this trend with 78 per cent of the trades taking place in Cash group securities.

TURNOVER ON THE BOMBAY STOCK EXCHANGE

(Rs. Crores)

Financial Year	TURNOVER			%age of TOTAL	
	A Group	B Group	Total	A(%)	B(%)
1988-89	17357	3206	20563	84.4	15.6
1989-90	25213	4173	29386	85.8	14.2
1990-91	28863	7149	36012	80.1	19.9
1991-92	54610	17168	71778	76.1	23.9
1992-93	33207	12489	15696	72.7	27.3
1993-94	62212	22324	84536	73.6	26.4
1994-95 (Apr.-Jan.)	13895	43323	62218	22.3	77.7

PROPOSAL FOR CONSIDERATION

In the absence of institutional arrangements like central depository system and banking facilities for margin trading, badla system is the most appropriate system in Indian conditions. Options and futures trading is not feasible (or even desirable) at our level of economic and institutional development. Futures trading is very much akin to badla trading, where, for delivery in future the contract price normally includes an interest component. If there is too much deviation in price, arbitragers bring them in equilibrium. Options trading is more of trading in risk among different participants in the stock market. It is zero-sum game and is hardly is going to add any value to our savings mobilizations efforts and/or resource allocation. Though Foreign Institutional Investors (FII) and some suave Indian brokers may benefit, it would be at the cost of small investors and inexperienced but adventurous Indian brokers.

However, to have an efficient and credible badla system operating :

1) Stock Exchange Authorities (SEA) should not fix havala rates and margins for bulls and bears after gauging the market mood (i.e., overbought or oversold position). Let them not try to steer the market to a desired level. Let the market forces deter mine the index level or price of an individual security. The object of fixing havala rates is to facilitate *marking to the market* of carry over business. Let it be objectively fixed at the closing price of a valan, unless there are reasons to believe that towards end of the session, prices have been manipulated.

2) The SEA will have to do a much better job of margin collections. They should not be wasting their time and energy in i) fixing different margins for bulls and bears, ii) varying percentage of havala rates for different securities, and iii) making constant changes in percentage from valan to valan. This process is highly subjective and normally invites unwarranted interference from the brokers. It also results in considerable amount of paper work and complexity in computing margins due. Monitoring becomes a difficult job.

Margin fixing should be a simple affair. It should be a fixed percentage of the total value of carry over business on gross basis (i.e., sold positions should not be netted against bought position). The percentage should be sufficiently high (say, 35 per cent) so as to act

as a deterrent to high speculation. Such a formula would be simple to implement and monitor. Scrip-wise details would not be required to compute margins.

Further, in computing gross business, there should be insistence on reporting of all outstanding business. Principal to principal deals between brokers (popularly known as 'chalu upla') should be effectively stopped. SEA should not entertain any debit or credit notes among brokers. Transactions subject to 'vandhas' (Objection memos) should not be excluded from computing outstanding business and margins should be collected even on transactions where prices are disputed. It would reduce incentives for brokers to report discrepancies with each others' connivance.

3) SEA should also limit brokers' total carry over business to 12.5 times of their net capital (i.e., enforce capital adequacy norms). This provision is intended to bar brokers from doing excessive business that could lead them to bankruptcy in a declining market. This is primarily intended to protect the investors, who in good faith keep their security and cash deposited with brokers, however, temporarily it may be. There should be an effective segregation of clients' securities and cash balances from those of brokers.

4) Inspection of brokers' books by SEA has to be a common practice. Any breach of rules must be severely punished. Monetary fines would not do. Suspension from trading should be a common penalty. Message has to be conveyed that the SEA means business.

Finally, the SEBI is urged to reintroduce badla but only after making sure that the Stock Exchange authorities would behave in a responsible manner and have equipped themselves properly with the wherewithal to ensure effective monitoring. Stock Exchanges as a self-regulatory organizations (SROs) would have to devise systems (particularly, those of fixing havala rates, margin collections and enforcement of capital adequacy norms) which are not prone to unwarranted influences.