Rolling Settlement in Stock Exchange

INTRODUCTION

This article aims to understand the concept of rolling settlement in stock exchanges in some depth. It aims to focus on the following aspects-

- Meaning, features and concepts associated with rolling settlement
- Application of rolling settlement system in various stock exchanges
- Advantages and disadvantages of rolling settlement
- Scope for improvement and suggested future changes

DEFINITION

Rolling Settlement process , also known as Compulsory Rolling Settlement (CRS) where trades on a stock exchange were to be accounted for and settled on T i.e. trade day plus "X" trading days, where "X" could be 1,2,3,4 or 5 days[1]. Thus, in essence, it means that if say a T+n, where n is the number of days system of rolling settlement was to be followed, trades accounted for on the T i.e. trade day were to be settled on the nth working day minus the T day.

FEATURES

The major features of rolling settlement are as follows[2]-

1. India follows a system of rolling settlement of T+2 days, wherein the trades accounted for on a certain T i.e. trade day is to be compulsorily settled 2 working days later minus the T day.

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[1] Bombay Stock Exchange, bseindia.com, *FAQs on Rolling Settlement*, available at http://www.bseindia.com/investors/FAQRolling.aspx (Last visited on 22nd December,2015).
[2] Economic Times, *ET in the classroom: Understanding trade settlement cycle*, December 12,2012, available at http://articles.economictimes.indiatimes.com/2012-12-14/news/35820050_1_settlement-cycle-trade-day-exchange-sets (Last visited on December 22, 2015).

2. The day for payment in rolling settlement system, does not include bank holidays, exchange holidays, Saturdays and Sundays.
3. Rolling settlement does not make much of a difference to intra-day traders and is forbidden for institutional investors. Retail traders, via a system of pay-in and pay-out i.e. sale and exchange of securities for funds.
4. In the event of book closure or record date, a “No-delivery” period is followed, wherein securities are traded but settlement takes place after such a period is over. It is done to secure investor’s corporate entitlement.

INTRODUCTION IN INDIAN STOCK EXCHANGES

Over The Counter Exchange of India (OTCEI) was the first exchange to bring in the CRS in India, when the NSE allowed the concept of CRS in demit account dealings[3].

1. A brief timeline of Rolling settlement and its evolution in Indian stock markets is mentioned below[4]-
2. Optional Rolling Settlement started by SEBI for demat scrips for the first time in 1998. Demat scrips refers to electronic book-keeping.
3. Rolling settlement cycle of T+5, was introduced for demat shares for the first time on 15th January, 1998.
4. SEBI chose 10 scrips for compulsory Rolling Settlement on a T+5 basis, starting 10 January, 2000.
5. In March, 2001, the Finance Ministry suggested that Rolling Settlement be extended to 200 'A' category stocks in Modified Carry Forward Scheme (MCFS).
6. Rolling settlement was made compulsory for all scrips by SEBI starting July 2, 2001in ALBM (Automated Lending and Borrowing Mechanism) /BLESS (Borrowing and Lending Securities Scheme/ MCFS (Modified Carry Forward Scheme) categories.

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[3] cbse.nic.in, Chapter 6- UNDERSTANDING THE ROLLING SETTLEMENT, available at http://cbse.nic.in/fmm-12/FMM%20II_Chapter%206.pdf (Last visited on December 22, 2015).

[4] shodhgangainflib.net, Rajeev. G ,*Capital market reforms and corporate investment behaviour in India*, Thesis. Department of Economics, Dr. John Matthai Centre, University of Calicut, 2007 CAPITAL MARKET REFORMS, available at http://shodhganga.inflibnet.ac.in/bitstream/10603/20514/12/12_chapter%203.pdf (Last visited on December 22, 2015).

7. SEBI introduced Rolling Settlement for all stocks in all stock exchanges on December 31, 2001, ushering in a landmark change.

The Account period of settling transactions was followed in India for a long time. It worked on the idea that transactions for an entire week were to be settled on a pre-specified date the very next week. However, this process was considered too technical and cumbersome. The G-30, in 1989, called for gradual replacement of this process with rolling settlement system, with the first proposal being the T+5 mode of settlement and later the T+3. Thus, keeping in mind, the best practices followed worldwide, the SEBI with effect from July 2, 2001, mandated CRS in all large cap companies mostly part of BSE- 200 Index and the scrips with a facility of deferral of the trading positions on T+5 basis. SEBI, starting December 31, 2001, had trading and settlement in all listed securities compulsory to be settled under CRS on T+5 basis and Weekly or Account period settlement discontinued permanently. With effect from April 1, 2002, trades were to be settled on T+3 basis as against T+5 earlier[5].

The stock markets following Account Period system of settling payments faced bigger settlement risks coupled with the chance that there could be problems when it came to settling debts accounting to different working days on a pre-specified date the next week. This settlement risk is lowered in CRS as the settlement of debts accounting to different working days takes place on entirely separate occasions[6].

INTRODUCTION OF T+2 SYSTEM OF ROLLING SETTLEMENT

Starting 1st April, 2003, SEBI transitioned form from the T+3 schedules to the T+2 schedules[7].

SEBI has advised stock exchanges to put in these facilities to help in implementation of T+2 settlement[8]-

(a) There would be a set time limit and manner for late submissions by custodians while ensuring that downloading of final obligation files by brokers was not delayed.

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[5] *Supra* note 1.
[6] *Id.,* note 5.
[7] National Stock Exchange-India, nse-india.com, *Secondary Market- Clearing and Settlement,* available at, http://www.nse-india.com/content/us/ismr2004ch5.pdf (Last visited on December 22, 2015).
[8] *Id.,* note 7.

(b) Stringent fines to be imposed on late submissions by custodians.

(c) A system was to be put in place for dealing with fund shortfall pertaining to funds and securities in an efficient manner which adhered to the decided time limit for paying out.

(d) Stock exchanges were to change their laws to ensure mandatory pay-outs were materialized between brokers and clients for sale and exchange of securities within 24 of the said transaction.

(e) The stock exchange was to come up with an alternate system of clearance and settling for the companies whose transactions was yet to be dematerialized.

(f) There was to be a strict mode of identification and greater attention was to be paid to ensure there was no change in the client ID to ensure that financial irregularities were controlled. Furthermore fines were to be imposed in case these norms were not followed.

(g) Members of stock exchanges were to adopt automatic downloading of files pertaining to payment of securities and funds. They were also asked for direct payment and transfer of securities/funds to clients account of paying out.

(h) Facilities allowing custodians to confirm transactions online, keeping a stock of the depository and bank account details of the parties involved, mandatorily asking clients to pay in via online transmission and sending pay out files to the bank while asking them to clear client credits online were to be put in for greater convenience in conducting business.

ACTIVITY SCHEDULE FOLLOWED IN T+2 SETTLEMENT[9]-

Sr. No.	Day	Time	Description of Activity
1.	T		Trade Day
2.	T+1	By 11.00 am	Custodians conform the trades. However, there is a facility for late Confirmations.
		By 1.30 pm	Process and download obligation files to brokers/custodians
3.	T+2	By 11.00 am	Pay-in of securities and funds
		By 1.30 pm	Pay-out of securities and funds

ACTIVITY SCHEDULE TO BE FOLLOWED BY STOCK BROKERS[10]

Stoke brokers have to mandatorily follow the aforementioned schedule listed by SEBI-

S. No.	Day	Time	Description of activity
1.	T		Trade Day
2.	T+2	Until 10.30 am	Accept pay-in instructions from investors into pool account
		By 10.30 am	Submit final pay-in files to the depository and the clearing bank.

[9] *Id.,* note 8.
[10] *Id.,* note 9.

ROLLING SETTLEMENT CYCLE FOR NORMAL MARKETS[11]

	Activity	Day	Timings
Trading	Rolling Settlement Trading	T day	
Clearing	Download of obligation of members /custodians by NSCCL	T+1 days	By 1.30 pm
	Custodial Confirmation		
	Delivery Generation - Members receive obligations to be fulfilled		
Settlement	Members give instructions for paying – in of securities i.e. move securities in the settlement A/c of NSCCL	T+2 days	By 10.30 am
			At 11.00 am
	Securities and Funds pay in		At 1.30 pm
	Securities and Funds pay out		By 2.30 pm
	Valuation of shortages based on T+1 closing prices		
Post Settlement	Auction	T+3 days	
	Bad Delivery Reporting	T+4 days	
	Auction settlement	T+5 days	
	Rectified bad delivery pay-in and pay-out	T+6 days	
	Re-bad delivery reporting and pickup	T+8 days	
	Close out of re-bad delivery and funds pay-in & pay-out	T+9 days	

[11] *Supra* note 3.

ORDER TO BUY/SELL

These are the various types of orders involved with buying/selling[12]-

- Day order- Meant to set a limit for trading for one day; automatically cancelled on non-fulfillment of the limit set.
- Immediate or Cancel Order (IOC)- As soon as an IOC is placed, it could be executed or cancelling in the happening or non-happening of the match so sought.
- Stop Loss (SL) order- Activation when securities reach or cross over a set price rate.
- Disclosed Quantity (DQ) order- It helps in specification of quantity.

IMPORTANT DOCUMENTS NEEDED

There are vital documents needed for completing transactions successfully in an exchange. These are namely[13]-

1. Order Confirmation Slip- It is provided by the broker after placing the order with specific conditions.
2. Trade Confirmation Slip- It is provided after completion of the trade.
3. Contract note- It is to be provided within 24 hours of the said transaction as it contains information pertaining to the trade, brokerage and other fiscal charges. The contract note is to be carefully preserved as it is extremely useful in tax and dispute related circumstances wherein it can be used to clarify the exact time and date of the said transaction in question.

[12] *Id.,* note 11.
[13] *Id;* note 12.

RELATED PROVISIONS IN SECURITIES CONTRACTS (REGULATION) RULES, 1957

Some sections in Securities Contracts (Regulation) Rules, 1957, have instilled a greater sense of confidence in the rolling settlement system by not allowing parties to get away with fraudulent acts and instilled a greater sense of confidence and security in the aforementioned settlement system, by bringing in a greater sense of accountability. These are[14]:

1. Individuals will be allowed to become members of a stock exchange on a declaration as per Section 8 (e) on an admission in writing that they have not been convicted of offences involving dishonesty or fraud. This ensures that tricksters are de-barred from participating in the exchange in the first place.
2. Under Section 11 of this act, if the Central government, after conducting an enquiry under Section 6 (c) of the same act, directs the governing body to take action against an individual, they are to abide by those orders irrespective of anything to the contrary contained in the rules or bye-laws of the stock exchange concerned. The governing body is bound to follow these instructions unless the government repudiates them. This entrusts the government with immense punitive powers, which are to be carefully used after completion of a formal enquiry.
3. Section 19 (3) (a) (v) made it mandatory for letters pertaining to allotment and rights to state mode of calculation of next payment of dividend or interest on securities. This ensures that there are no slip-ups as the mode of payment has been fixed in the written form.
4. Section 19 (3) (q) grants shareholders reasonable time not less than four weeks to provide for the payment of the equivalent of the value of the fractional rights in cash. This ensures that parties have adequate time in hand for completing transactions.
5. As per Section 19 (1) (f) any public company that wants to get listed in the stock exchange has to provide certified copies of agreements or other documents relating to arrangements with or between:(i) vendors and/or promoters, (ii) underwriters and sub-underwriters, (iii) brokers and sub-brokers.

[14] THE SECURITIES CONTRACTS (REGULATION) RULES, 1957.

ADVANTAGES OF ROLLING SETTLEMENT OVER ACCOUNT SETTLEMENT SYSTEM

These are the various advantages that rolling settlement system holds over account settlement system[15]:

1. In rolling settlement system, thanks to differential dates fixed and a uniform system of T+2 settlements that is now followed, transactions are taken care of on a priority basis. Those transactions that were fixed earlier are taken care of on a sooner basis. This system of priority is nonexistent in the account settlement system where all the transactions are cached together for clearance next week, irrespective of the day of the week they were initially fixed. Thus, in rolling settlement, thanks to a more organized clearance system, funds and securities can be converted on a more convenient basis.

2. Rolling settlement classifies cash and future markets. This removes scope for excess speculation; thereby allowing a fair system of price discovery unlike account settlement where due to the absence of any such system of classification price discovery process suffers.

3. Since account settlement followed a system of a five day reprieve before accounts could be settled, this had led to markets being volatile due to the immense pressure on buyers and sellers to complete deals on the last trading day. However, in rolling settlement, such a scope for volatility is nonexistent due to a one day reprieve in place.

4. Account settlement system had allowed chances of intra-day and intra-settlement speculation that led to outstanding positions and greater settlement risks, which rolling settlement does not allow with its pre-fixed system of "X" days to settle transactions.

5. Account settlement system allowed investors to arbitrarily shift from one exchange to another, which has been successfully debarred under the rolling settlement system.

[15] *Supra;* note 13.

PROPOSAL FOR CHANGING TO THE T+1 SYSTEM

It has been suggested by SEBI that it would be more prudent to change from the existing T+2 systems to the T+1 system for the following advantages[16]

1. By shortening the duration of settlement it would allow business to be conducted more efficiently and ensure that the risks posed by non-payment and/or non-delivery of shares is reduced significantly. It would also speeden up the process of settlement and ensures more transactions to take place.
2. It would provide investors greater liquidity by settling exchange of funds and securities one day in advance. Furthermore, they could invest their cash in different enterprises likewise. Since markets face a lot of volatility if brings in greater efficiency in management of capital and returns to investors.
3. By settling transactions one day in advance, investors potentially ensure that they have greater mobility in dealing with their shares so purchased; which they could potentially share to newer parties and build upon their existing profits.
4. Investors are allowed more liquidity and as a result they can undertake more transactions, earning greater profits, since the shorter duration of settlement allows them to frame and re-frame their strategies with respect to prevailing market conditions.
5. Due to quicker and more convenient transactions, there would be increased profits, at least theoretically and allows all the participants in the market—stock exchanges, depositories, depository participants, and even the government to be benefitted by the increase in taxes, fees etc.

[16] moneylife.in, *T+1 settlement proposed by SEBI: How will it benefit you?,* April 23,2013,available at http://www.moneylife.in/article/t1-settlement-system-proposed-by-sebi-how-will-it-benefit-you/32348.html (Last visited on December 22,2015).

CONCLUSION

In conclusion, I would like to state:

1- Rolling settlement is a more balanced and accountable system of carrying out business that has been introduced.
2- It ensures that payments are settled on a priority basis, saving on time and procedures while ensuring greater safety to the parties involved in the said transactions.
3- It is to be noted that the transition from T+5 to the T+2 systems, has increased the scope of carrying out a greater number of transactions.
4- Rolling settlement is a better system of carrying out business when compared to the account settlement system. It should not be replaced by the latter but continue as such.
5- Rolling settlement transition from T+2 to T+1 should take place after consulting and getting the approval from all stakeholders like stock brokers, buyers, SEBI, business institutions post a thorough study about its possible feasibility.

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