Exchange and Index

Exchange: Definition

Role of Stock Exchanges

Major Stock Exchanges

Exchange: Definition

Role of Stock Exchanges

Major Stock Exchanges

Exchange: Definition

- An entity providing "trading" facilities for stock brokers and traders, to trade stocks and other securities
- Securities traded on a stock exchange include:

1. Shares issued by companies
2. Unit trusts
3. Derivatives
4. Pooled investment products
5. Bonds

Exchange: Features

- Provides facilities for the issue and redemption of securities as well as other financial instruments and capital events including the payment of income and dividends
- Most important component of a stock market
- Supply and demand in stock markets affect the price of stocks
- The initial offering of stocks and bonds to investors is done in the primary market and subsequent trading is done in the secondary market
- Market participants : **Intermediaries , Market Organisers, Company and Investors**

Clearing Firm

- Works with the exchanges to handle confirmation, delivery and settlement of transactions
- Key role in ensuring that executed trades are settled within a specified period of time and in an efficient manner (Also called clearing corporation or clearing house.)
- Acts as third parties to all futures and options contracts - as a buyer to every clearing member seller and a seller to every clearing member buyer

Clearing Firm

- Each futures exchange has its own clearing house
- All members of an exchange are required to clear their trades through the clearing house at the end of each trading session
- Deposit with the clearing house a sum of money (based on clearinghouse margin requirements) sufficient to cover the member's debit balance
- Responsible to all members for the fulfillment of the contracts
- Smaller investment firms do not have the capability to execute stock trades, so they have to go through a Clearing firm to conduct business for their clients

Clearing Members

- A subset of the exchange members usually must meet financial and operating standards that exceed regulatory and exchange minimums
- Serve as intermediaries in their provision of clearing services to clients, which may include non-clearing exchange members or individuals or firms that are not members of the exchange
- Non-clearing exchange members must arrange for a clearing firm to assume financial responsibility for their trades and those of any non-members of the exchange for whom they execute trades
- Both the retail client and the non-clearing firm are clients

Money Settlement Procedures

- Key element in the clearing arrangements for exchange-traded derivatives is a bank or a group of banks through which money settlements are effected
- Two basic models can be identified:
  - *Central Bank Model*
  - *Private Settlement Bank Model*

Central Bank Model

- Money settlements between the clearing house and its clearing members are effected in central bank funds
- Model requires the clearing house and its clearing members to have access to central bank funds accounts
- Settlements can be effected only during the operating hours of the central bank payment system

Private Settlement Bank Model

- Each clearing member is required to establish a banking relationship with one of a group of commercial banks specified by the clearing house
- Clearing house itself has an account at each of the settlement banks
- Often extend intraday credit to clearing members
- Extends unsecured intraday credit to the clearing house by allowing it to overdraw its account in anticipation of a subsequent balancing transfer of funds from another settlement bank

Private Settlement Bank Model

- ***Private settlement banks*** may be used because:

  (1) The clearing house or many of its members lack access to central bank accounts

  (2) Private settlement banks are willing to provide credit (especially intraday credit) to clearing members or to the clearing house in amounts or on terms that the central bank is unwilling to provide

  (3) The clearing house seeks to complete settlements with its clearing members earlier in the day than is possible under the operating hours and finality rules of the central bank payment system

Exchange: Definition

Role of Stock Exchanges

Major Stock Exchanges

Major Stock Exchanges

- New York Stock Exchange(NYSE)
- Tokyo Stock Exchange
- NASDAQ
- London Stock Exchange
- Bombay Stock Exchange
- National Stock Exchange of India

Market Index: Definition

Benefits

Index Classification

Important Indices

Market Index: Definition

Benefits

Index Classification

Important Indices

Market Index: Definition

- An index is designed to measure price changes of an overall market, such as the stock market or the bond market.
- Customized basket of securities that tracks a particular market or segment
- Examples- S&P, Dow Jones, NIFTY, Sensex

Market Index: Definition

Benefits

Index Classification

Important Indices

Benefits

- Quick view on general condition of the market
- 70% of a stock price movement is tied to the total market
- How a specified portfolio of share prices are moving in order to give an indication of market trends

Market Index: Definition

Benefits

Index Classification

Important Indices

Classification

Based on location

1. **Global Stock Market Index**

   Includes companies without regard for where they are domiciled or traded

   For eg - MSCI World and S&P Global 100

2. **National Index**

   Represents the performance of the stock market of a given nation.

   For eg - The American S&P 500, the Japanese Nikkei 225, and the British FTSE 100

Market Index: Definition

Benefits

Index Classification

Important Indices

Examples : S&P CNX Nifty (Nifty)

- Owned and managed by India Index Services and Products Ltd.
- 50 stock index accounting for 21 sectors of the economy
- Maintained by the S&P Index Committee, a team of Standard & Poor's economists and index analysts

Examples : S&P CNX Nifty (Nifty)

- The total traded value for the last six months of all Nifty stocks is approximately 52% of the traded value of all stocks on the NSE
- Nifty stocks represent about 63% of the Free Float Market Capitalization as on Dec 31, 2009
- Impact cost of the S&P CNX Nifty for a portfolio size of Rs.2 crore is 0.10%
- S&P CNX Nifty is professionally maintained and is ideal for derivatives trading

Examples : S&P 500

- First published in 1957
- Includes 500 leading companies in leading industries of the U.S. economy
- Captures 75% coverage of U.S. equities

S&P 500: Criteria For Index Additions

- **US Company**

  Location of Company’s operations, Corporate Structure etc.
- **Market Capitalization**

  Companies with market cap in excess of US$ 3.5 billion
- **Public Float**

  At least 50% Public Float
- **Financial Viability**

  Companies should have four consecutive quarters of positive earnings

S&P 500: Criteria For Index Removal

- Companies that substantially violate one or more of the criteria for index inclusion
- Companies involved in merger, acquisition, or significant restructuring such that they no longer meet the inclusion criteria