FINANCIAL MARKETS
AN OVERVIEW OF MARKETS AND FUNCTIONS

Financial Market is a place or system to trade financial instruments including bonds, equites, the various international currencies and derivates.

Types of markets:

- Capital market (SEBI)
- Debt market (RBI)
- Foreign exchange markets (RBI)
- Commodity Market (SEBI)
- Mutual Fund Market (AMFI)
- Money market (RBI)

Overview of the markets:

Capital Market - The capital market is the market **wherein long-term loans and equity capital are raised and traded.** Companies, Government, Banks and Financial Institutions raise funds for their long-term uses through the capital market. Shares, debentures and bonds are issued and traded in the capital market.

Foreign exchange market -The foreign exchange markets are those markets wherein **the currencies of various countries are traded.** Trade between countries and counterparties in different countries must be settled in accepted currencies. Major foreign exchange trading centres are located in New York, Tokyo, London, Hong Kong, Singapore, Paris and Frankfurt.

Insurance markets – Insurance market has **a crucial role to play in as much as it provides certain risk management tools to the corporates and financial markets**. Insurance companies are broadly divided into two categories, Life Insurance Companies and General Insurance Companies. The insurance companies have the need to maintain funds which are invested in the market. These investments are made in approved securities and deposit funds with banks.

Mutual Funds - A mutual fund is a trust **that collects money from a number of investors who share a common investment objective** and invests the same in equities, bonds, money market instruments and / or other securities. And the income / gain generated from this collective investment is distributed proportionately.

Money market -The money market is a general term for the markets in **which banks lend to and borrow money or money equivalent from each other**, trade in securities / treasury bills and financial instruments such as Certificates of Deposit (CDs) or enter into agreements such as Repos and Reverse Repos. The market normally trades in instruments with maturities up to one year.

ROLES AND FUNCTIONS OF PARTICIPANTS IN THE FINANCIAL MARKET

- **Banks -** Banks participate **in the capital market and money market**. Within the capital market, banks take active part in bond markets. Banks may invest in equity and mutual funds as a part of their fund management. Banks take active trading interest in the bond market and have certain exposures to the equity market also.

- **Primary dealers-** **They are registered entities with RBI who have the right to purchase and sell govt securities.** They buy securities directly from the RBI aiming to resell them to buyers.

- **Financial Institutions (FIs)** - **FIs provide / lend long-term funds for industry and agriculture.** FIs raise their resources through long-term bonds from financial system and borrowings from international financial institutions like International Finance Corporation (IFC), Asian Development Bank (ADB) International Development Association (IDA), International Bank for Reconstruction and Development (IBRD), etc.

- **Stock Exchanges** – A stock exchange **is a place where securities are traded.** It is duly approved by the Regulators to provide sale and purchase of securities by "open cry" or "online" on behalf of investors through brokers. The stock exchanges provide clearing house facilities for netting of payments and securities delivery. Such clearing houses guarantee all payments and deliveries. Securities traded in stock exchanges include equities, debt, and derivatives.

- **Brokers -** Only brokers **approved by Capital Market Regulator can operate on stock exchange.** Brokers perform the job of intermediating between buyers and seller of securities. They help in building up order book, price discovery, and are responsible for a contract being honoured. For their services, brokers earn a fee known as brokerage.

- **Foreign Institutional Investors (FIIs) -** FIIs are foreign based funds authorised by Capital Market Regulator to **invest in home countries' equity and debt market through stock exchanges.**

- **Custodians -** Custodians are organizations which **are allowed to hold securities on behalf of customers and carry out operations on their**

behalf. In view of their position and as they handle the payment and settlements, banks are able to play the role of custodians effectively. Thus, most banks perform the role of custodians.

- **Depositories -** Depositories hold securities in demat (electronic) form. On instructions of stock exchange clearing house, supported by documentation, **a depository transfers securities from sellers to buyers' accounts in electronic form.**
  National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL) are the two major depositories that provide dematerialized holding of securities by the investors.