NISM CERTIFICATION EXAMINATION WORK BOOK

VII

# Securities Operations and Risk Management



National Institute of Securities Markets
A Capacity Building Initiative of SEBI

# Workbook
# for
# NISM-Series-VII: Securities Operations and Risk Management
# Certification Examination




**National Institute of Securities Markets**
**www.nism.ac.in**

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Securities Operations and Risk Management.

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**Foreword**

NISM is a leading provider of high-end professional education, certifications, training and research in financial markets. NISM engages in capacity building among stakeholders in the securities markets, through professional education, financial literacy, enhancing governance standards and fostering policy research.

The NISM certification programs aim at enhancing the quality and standards of professionals employed in various segments of the financial sector. NISM develops and conducts certification examinations and Continuing Professional Education (CPE) programs that aim at ensuring that professionals meet the defined minimum common knowledge benchmark for various critical securities market functions.

NISM certification examinations and educational programs service different securities market intermediaries focusing on varied product lines and functional areas. NISM certifications have established knowledge benchmarks for various market products and functions such as equities, mutual funds, derivatives, compliance, operations, advisory and research. NISM certification examinations and training programs provide a structured learning plan and career path to students and job aspirants, wishing to make a professional career in the securities markets.

NISM supports candidates by providing lucid and focused workbooks that assist them in understanding the subject and preparing for NISM Examinations. This book covers all important aspects related to the stock brokers operations, starting from client on-boarding to trade life cycle and includes compliance requirements related to report submission and redressal of investor grievances. This book will be immensely useful to all those who want to learn about the various functions of a broker's operations and risk management in the securities markets.

**Sashi Krishnan**
**Director**

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While the NISM Certification examination will be largely based on material in this workbook, NISM does not guarantee that all questions in the examination will be from material covered herein.

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**About NISM Certifications**

NISM is engaged in developing and administering Certification Examinations and Continuing Professional Education (CPE) Programmes for professionals employed in various segments of the Indian securities markets. These Certifications and CPE Programmes are being developed and administered by NISM as mandated under Securities and Exchange Board of India (Certification of Associated Persons in the Securities Markets) Regulations, 2007.

The skills, expertise and ethics of professionals in the securities markets are crucial in providing effective intermediation to investors and in increasing the investor confidence in market systems and processes. NISM seeks to ensure that market intermediaries meet defined minimum common benchmark of required functional knowledge through Certification Examinations and CPE Programmes on Mutual Funds, Equities, Derivatives, Securities Operations, Compliance, Portfolio Management etc.

These Certifications create quality market professionals and catalyzes greater investor participation in the markets. They also provide structured career paths to students and job aspirants in the securities markets.

**About the Certification Examination on Securities Operations and Risk Management**

The examination seeks to create a common minimum knowledge benchmark as the requisite standard for associated persons of a registered stock-broker /trading member / clearing member in recognized stock exchanges, involved in (a) assets or funds of investor or clients (b) redressal of investor grievances, (c) internal control or risk management and (d) activities having a bearing on operational risk.

**Examination Objectives**

On successful completion of the examination, the candidate should:

- Know the basics of the Indian securities market, the different products traded and the various market participants and the respective roles they play in the Indian securities market.
- Understand the regulatory framework and the role of the Securities Exchange Board of India.
- Understand the trade life cycle, the steps and participants involved in the trade life cycle.
- Know the various functions of the Front Office, Middle Office and Back Office in a Securities Broking Firm.
- Understand how the risks are managed in a securities broking firm, the clearing and settlement process.
- Understand the various procedures for redress of investor grievances

**Assessment Structure**

The examination consists of 100 questions of 1 mark each and should be completed in 2 hours. The passing score on the examination is 50%. There shall be negative marking of 25% of the marks assigned to a question.

**Examination Structure**

The exam covers knowledge competencies related to the basics of securities market, the trade life cycle, knowledge about the functioning of the front office, middle office and back office in a broking firm. The risk management practices and the clearing and settlement process for a trade executed in the secondary market.

**How to register and take the examination**

To find out more and register for the examination please visit www.nism.ac.in

**Feedback and Queries**

For any feedback and/or queries, please write back at certification@nism.ac.in.

## Syllabus Outline with Weightages

| Chapter No. | Chapter Name | Weightage (%) |
|---|---|---|
| 1 | Introduction to Securities Market | 5 % |
| 2 | Market Participants in the Securities Market | 10% |
| 3 | Introduction to Securities Broking Operations | 20% |
| 4 | Risk Management | 15% |
| 5 | Clearing Process | 15% |
| 6 | Settlement Process | 15% |
| 7 | Investor Grievances and Arbitration | 10% |
| 8 | Other Services Provided by Brokers | 10% |

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# CHAPTER 1: INTRODUCTION TO THE SECURITIES MARKET

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Meaning of securities market and its role in the Indian Economy
- The different segments of securities market
- Products traded in Indian securities market
- Concept of International Financial Services Centres (IFSC)

## 1.1 Introduction

The financial markets enable efficient transfer and allocation of financial resources for productive activities in the economy. Users of funds include businesses, governments and households who seek funds to run their activities. Households, businesses and governments also act as providers of surplus funds. Intermediaries such as banks, financial institutions, mutual funds and insurance companies, among others, channelize the available surplus funds from lenders to the users.

The function of the financial markets is to ensure that economic activity is enabled by providing access of funds to those who need it for consumption or productive activity. They provide a way for aggregation of funds from a large number of investors and make it available for productive economic activity. In the absence of financial markets such aggregation may not be possible. An efficient financial market ensures that the transfer of funds happens at a cost that makes it attractive for savers to save and lend and for users to borrow funds. The markets must enable the dissemination of relevant information to all the participants in the market so that the decision on price of funds is made after integrating all available information. It must also allow the participants to review their funding decisions given new information and to re-allocate the resources accordingly. Therefore, providing liquidity and exit options are an important function of financial markets. Financial market regulations and regulators focus on setting up systems and processes in place to streamline the activities associated with the transfer of funds. The financial market comprises of the money market and the securities markets.

The marketplace where buyers and sellers interact with each other and participate in the trading of money, bonds, shares and other assets is the financial market. Financial markets are the centre that facilitate buying and selling of financial instruments, claims or services. It caters to the credit needs of the individuals, firms and institutions. It deals with the financial assets of different types such as currency deposits, cheques, bills, bonds etc. it is defined as a transmission mechanism between investors and the borrowers through which transfer of funds is facilitated. It consists of individual investors, financial institutions and other intermediaries who are linked by a formal trading rules and communication network

for trading the various financial assets and credit instruments. Financial markets can be broadly classified as Capital Market (Securities Market) and Money market.

In this book however, we are going to focus specifically on securities market. The term "**Securities**" as defined in the Securities Contract Regulation Act (SCRA), 1956 includes the following:

i. Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

ii. Derivatives;

iii. Units or any other instrument issued by any Collective Investment Scheme;

iv. Security receipt as defined in the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

v. Units or any other instrument issued by any pooled investment vehicle;

vi. Units or any other such instrument issued to the investors under any mutual fund scheme;[2]

vii. Any certificate or instrument, issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;

viii. Government Securities

ix. Such other instruments as may be declared by the Central Government to be securities, and

x. Rights or interest in securities.

xi. "Electronic Gold Receipt" means an electronic receipt issued on the basis of deposit of underlying physical gold in accordance with the regulations made by the Securities and Exchange Board of India under section 31 of the said Act.

xii. Zero Coupon Zero Principal Instruments

Securities market help in transfer of resources from those with idle resources/surplus to others who have a productive need for them. To state formally, securities markets provide channels for allocation of savings to investments and thereby decouple these two activities. As a result, the savers and investors are not constrained by their individual abilities, but by

[2] "Securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938 (4 of 1938);

the economy's abilities to save and invest respectively, which inevitably enhances savings and investment in the economy.

## 1.2 Securities Market

The securities market has two interdependent and inseparable segments, *viz.*, the new issues (the primary market) and trading in existing issues (secondary) market.

The *primary market* is used by issuers for raising capital from the investors by making Initial Public Offers or rights issues or Further Public Offer (FPO) or private placement. On the other hand, the *secondary market* provides liquidity to these instruments, through trading and settlement on the stock Exchanges. An active secondary market promotes the growth of the primary market and capital formation, since the investors in the primary market are assured of a continuous market where they have an option to liquidate their investments. Thus, in the primary market, the issuer has direct contact with the investor, while in the secondary market, the dealings are between two investors and the issuer does not come into the picture.

Primary market is the market that ensures availability of adequate capital at reasonable rates to finance expansion, diversification or consolidation of companies. A secondary market on the other hand is the market where the buyer of securities in the primary market can transfer /sell these securities to another buyer.

The resources in the primary market can be raised either through the private placement route or through the public issue route by way of Initial Public Offer (IPO) or Follow on Public Offer (FPO). It is a *public issue*, if anybody and everybody can subscribe for it, whereas, if the issue is made to select group of people, then it is termed as *private placement*. In cases where fresh shares are issued to existing shareholders at a particular price, it is referred as *Rights Issue*, whereas if such issues are without involvement of any cost, it is referred as *Bonus issue/stock split.*

The secondary market on the other hand operates through two mediums, namely, the Over-The-Counter (OTC) market and the Exchange Traded Market/Screen Based Trading System (SBTS).

*OTC markets* are the informal type of markets where trades are negotiated. In this type of market, the securities are traded over the counter and settled bilaterally.

The other option of trading is through the stock exchange route, where trading and settlement is done through the Stock Exchanges and the buyers and sellers don't know each other. The settlements of trades are carried out as per a fixed time schedule. The trades executed on the exchange are settled through the clearing corporation, who acts as a counterparty and guarantees settlement.

There are several major players in the primary market. These include the merchant bankers, mutual funds, financial institutions, Foreign Portfolio Investors (FPIs), individual investors; the issuers including companies, bodies corporate, lawyers, bankers to the issue, brokers, depositories, self-certified syndicate banks (SCSBs) and depository participants. The stock exchanges are involved to the extent of providing platform for primary issuance and listing of the securities.

In the secondary market, there are the stock exchanges, clearing corporations, stock brokers (who are members of the stock exchanges), the mutual funds/asset management companies (AMCs), financial institutions, Foreign Portfolio Investors (FPIs), investment companies, individual investors, depository participants and banks.

The Registrars and Transfer Agents, Custodians and Depositories are capital market intermediaries which provide important infrastructure services to both the primary and secondary markets. These would be discussed in detail in the later sections of this workbook.

## 1.3 Money Market

Money Market is a short-term market and handles instrument from 1 day to 1 year. It is mostly used by Government, Banks and other corporate entities to tide over short-term requirements of funds. The entities having excess and the entities with shortage of funds participate in this market. The RBI uses the money market for transmission of its monetary policy direction by changing various Reserve ratios, conducting Open Market Operations, increasing or decreasing of policy rates, etc.

Participants in the Indian money market include Central Bank of India (RBI), Public Sector Banks, Private Sector Banks, Foreign Banks, Co-operative Banks, Financial Institutions, Insurance Companies, Mutual Funds, Primary Dealers, Bank cum Primary Dealers, Non-Banking Financial Companies (NBFCs), Corporates, Provident / Pension Funds, Payment Banks, Small Finance Banks, etc. The money market deals primarily in short-term debt securities and investments, such as bankers' acceptances, negotiable certificates of deposit (CDs), commercial papers, repos, Call/Notice/Term money and treasury bills (T-bills).

Money market is typically divided into two segments: (a) Borrowing and Lending segment with or without collaterals; (b) Asset Market involving purchase and sale of money market instruments.

These are explained briefly below:

a) ***Call Money:*** The call money market is an avenue for unsecured lending and borrowing of funds. This market is a purely interbank market in India restricted only to Scheduled Commercial Banks (SCBs) and the Primary Dealers (PDs). Call money transactions are dealt/ reported on the Reserve Bank of India's NDS-CALL (Negotiated Dealing System – Call) platform, which is managed by CCIL, and are

predominantly overnight (tenor of borrowing may be extended to account for weekends and holidays).

b) ***Notice Money:*** This is an extension of the interbank call market with uncollateralized lending and borrowing of funds for a period beyond overnight and up to 14 days. Notice money transactions are dealt / reported on the RBI's NDS-CALL.

c) ***Term Money***: This is an extension of the interbank call market for uncollateralized lending and borrowing of funds for a period between 15 days and 1 year. Term money transactions are dealt / reported on the RBI's NDS-CALL.

d) ***Market Repo***: Repo, also known as a ready forward contract, refers to borrowing funds via sale of securities with an agreement to repurchase the same at a future date with the interest for the borrowings incorporated in the repurchase price. Reverse repo is the exact opposite transaction which is essentially a collateralized lending of funds. Each repo/ reverse repo deal thus has two parts (or, two legs). The repo period (repo tenor) is the time between the two legs. The interest is computed on the actual amount borrowed by the repo seller which is the consideration amount in the repo's first leg. The lender receives the interest in the second leg when the security is bought back by the borrower at a higher consideration that includes the interest. RBI regulates the repo market in India and major participants are Scheduled Commercial Banks, Primary Dealers, Mutual Funds, NBFCs, Financial Institutions, Insurance Companies, Corporates, Provident / Pension Funds, Payment Banks, Small Finance Banks, etc. Repo transactions are allowed on Government Securities as well as corporate bonds. Repo transactions against G-secs are traded / reported on the Clearcorp Repo Order Matching System (CROMS) electronic platform of the Clearcorp Dealing Systems. These are settled by CCIL along with the G-secs.

e) ***Triparty Repo in Government Securities***: "Triparty repo" is a type of repo contract with a third party intermediary between the borrower and lender known as the Triparty Agent (TPA). The TPA does the collateral selection, payment and settlement, custody and management during repo period. Following RBI's authorization to CCIL to act as a TPA., The Tri Party Repo Dealing System (TREPS), an anonymous order matching trading platform, is provided by Clearcorp Dealing Systems (India) Ltd with CCIL as the Central Counterparty (CCP) for borrowing and lending of funds against government securities in India with a triparty arrangement. All the repo eligible entities can trade on TREPS, and the funds borrowed on TREPS are exempted from RBI's CRR/SLR computation and the security acquired under the deal is eligible for SLR by the acquiring Bank. Unlike Repo, TREPS facilitate the trading of Repo and the seller of the security has a right to substitute the security.

f) ***Treasury Bills (T-bills)***: In India, Treasury bills or T-bills are used for short term borrowing by the Government of India and are considered to be a part of the money market as they mature within a year from issue. These are basically zero coupon securities which are issued at a discount and are redeemed at par. Normally RBI

conducts weekly auctions (on Wednesday) for three tenors of T-bills: 91, 182 and 364 days. Treasury bills are traded on NDS-OM platform along with Government Securities.

g) ***Cash Management Bills (CMBs)***: Essentially very short term T-bills, Cash Management Bills (CMBs) are issued by the Government of India to fund the temporary mismatches in its cash flow. CMBs have maturities less than 91 days. This is issued to absorb excess liquidity in the system after auction for usual Treasury Bills on weekly basis.

h) ***Commercial Paper (CP)***: A Commercial Paper (CP) is used by Indian corporates to raise short-term unsecured funds. CPs are also discounted instruments like T-bills and are issued for Rs.5 lakh and multiples thereof for maturities between 7 days and one year. CP issuances are governed by RBI regulations. CPs are issued in dematerialised form and held with depository registered with SEBI. Companies, including Non-Banking Finance Companies (NBFCs) and All India Financial Institutions (AIFIs), are eligible to issue CPs subject to the condition that any fund-based facility availed of from bank(s) and/or financial institutions is classified as a standard asset by all financing banks/institutions at the time of issue. Other entities like co-operative societies/unions, government entities, trusts, limited liability partnerships and any other body corporate having presence in India with a net worth of Rs. 100 crore or higher subject to the condition as specified by RBI. The minimum credit rating, assigned by a Credit Rating Agency (CRA), for the issuance of CPs shall be 'A3' as per rating symbol and definition prescribed by SEBI. The Issuing and Paying Agent (IPA) shall be appointed for each CP issuance.

i) ***Certificate of Deposit (CD)***: Certificate of Deposits is a negotiable, unsecured money market instrument issued by a bank[3] as a Usance Promissory Note against funds deposited at the bank for a maturity period upto one year. CDs are also discounted instruments like T-bills and are issued for Rs.5 lakh and multiples thereof for maturities between 7 days and one year. All India Financial Institutions can issue CDs for a period not less than 1 year and not exceeding 3 years from the date of issue.

j) **Repo in Corporate Bond/ Corporate Debt Securities:** Repo in corporate bonds was introduced by RBI in 2010 and the eligible securities for Corporate Bond Repo include:

   a. Listed corporate bonds and debentures, (however, participants cannot borrow against the collateral of their own securities or those of related entities);
   b. CPs and CDs; and
   c. Units of Debt ETFs.
   d. Municipal Debt Securities

3 CDs can also be issued by the All India Financial Institution which shall be guided by the specific RBI Directions

e. Any other security of a local authority as may be specified in this behalf by the Central Government.

k) **Exchange Traded Tri-party Repo:** The Tri-party repo is a type of repo contract where a third entity (apart from the borrower and lender), called a Tri-Party Agent. A Tri-party agent acts as an intermediary between the two parties to facilitate services like collateral selection, payment and settlement, custody and management during the life of the transaction. Tri-party repo on corporate debt securities is available for trading on the exchanges. The aim to introduce Tri-party repo in corporate bonds was to improve liquidity in the corporate bond market. Tri-party repos are transacted as per directions issued by the Reserve Bank of India (RBI) from time to time. AMC Repo Clearing Ltd. (ARCL) is a limited purpose clearing corporation (LPCC) acts as a tri-party repo agent for corporate debt securities repo. The Tri-party repo product in corporate debt securities is currently traded on Exchange Debt Market Segment (sub-segment Tri-party repo Market). AMC Repo Clearing Ltd. does Clearing & Settlement of these transactions and also provide settlement guarantee for these transactions.

## 1.4 Products Traded in the Indian Securities Market

Investors in the Indian securities market have a wide choice of product base to choose from depending upon a person's risk appetite and needs. The different types of products available in equity, derivatives and debt markets are discussed below. These products are traded on various segments of Exchanges and sometimes on OTC / electronic trading also. In our workbook we will focus mainly on various segments of Stock Exchange and product traded on the same.

### 1.4.1 Equity / Cash Markets and its Products

The equity/cash segment of the stock exchange allows trading in shares, government securities, debentures, warrants, mutual funds and exchange traded funds (ETFs) etc.

***An Equity Share*** normally known as ordinary shares represents the form of fractional ownership in a business venture. Equity shareholders collectively own the company. They bear the risk and enjoy the rewards of ownership. Equity shares do not have a maturity date and have variable returns in the form of dividends and capital gains. Equity shareholders are entitled to voting rights. In the event of liquidation of company equities will have last preference. Typically, equity securities are riskier as compared to debt securities.

***Preference Shares***, also commonly known as preferred stock, are a special type of share where dividends are paid to shareholders prior to the issuance of equity stock dividends. Preference shareholders hold preferential rights over equity shareholders when it comes to sharing profits.

***Debentures*** are instruments for raising debt. Debenture is debt securities which indicate a loan to the company. Debentures typically have a maturity date and have a predefined return in the form of interest payments. Debentures in India are typically secured by tangible assets. There are fully convertible, non-convertible and partly convertible debentures. Fully convertible debentures will be converted into ordinary shares of the same company under specified terms and conditions. Partly convertible debentures (PCDs) will be partly converted into ordinary shares of the same company under specified terms and conditions. Thus, it has features of both debenture as well as equity. Non-Convertible Debentures (NCDs) are pure debt instruments without a feature of conversion. The NCDs are repayable on maturity. Thus, debentures can be pure debt or quasi-equity, as the case may be.

**Government Securities** are also known as "sovereign debt" and are generally issued via auctions and traded in the secondary market. Government bonds issued in local currency are considered risk free as the Government, being a sovereign entity, can print the currency to repay its obligation to bond holders. Government Securities are issued by central and state government. The dated securities issued by state government is known as State Government Securities (SGS).

***Warrants*** entitle an investor to buy equity shares after a specified time period at a given price.

***A Mutual Funds*** is an investment vehicle that pools money from numerous investors who wish to save or make investments having similar investment objective. A mutual fund invests in different types of securities in consonance with the investment objectives. A mutual fund company pools money from many investors and invests the money in stocks, bonds, money-market instruments, other securities or assets, or some combination of these investments, depending on the objectives of the fund. There are funds which invest in equities, better known as equity MF schemes which are considered riskier than debt mutual funds. Liquid mutual funds invest mainly in short term and very short term money market instruments. One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of various securities which would be quite difficult to create with a small amount of capital. Mutual Fund schemes are either open ended or close ended. Close ended mutual funds schemes are traded on the equity segment of the Exchange.

***Exchange Traded Fund :*** An ETF is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. The main difference between ETFs and other types of index funds is that ETFs don't try to outperform their corresponding index, but simply replicate the performance of the Index. Unlike regular mutual funds, an ETF trades like a common stock on a stock exchange. The traded price of an ETF changes throughout the day like any other stock, as it is bought and sold on the stock exchange. The trading

value of an ETF is based on the net asset value of the underlying stocks that an ETF represents.

***Indian Depository Receipt (IDR):*** Foreign companies are not allowed to directly list on the Indian stock exchanges. However, they are allowed to raise capital in Indian currency through an instrument called Indian Depository Receipt (IDR). An IDR is an instrument denominated in Indian Rupees in the form of a depository receipt created by a Domestic Depository (custodian of securities registered with the Securities and Exchange Board of India (SEBI)) against the underlying equity shares of issuing company to enable foreign companies to raise funds from the Indian securities Markets.[4] IDRs are issued by foreign companies to Indian investors. IDRs are depository receipts which have the equity shares of the issuing company as the underlying security. The underlying shares are held by a foreign custodian and the DRs are held in the Indian depository. IDRs are listed in the Indian stock exchanges. The investor can either hold the IDR, trade in them in the stock exchange or request for conversion/redemption into the underlying shares. Redemption/Conversion is permitted after 1 year from the date of listing of the IDRs. Two way fungibility of IDRs is permitted i.e., the depository receipt can be converted into underlying shares and the underlying shares can be converted into depository receipt. However, the number of shares that can be converted into depository receipt should be within the headroom available. The headroom for this purpose shall be the number of IDRs originally issued minus the number of IDRs outstanding, which is further adjusted for IDRs redeemed into underlying equity shares.

### 1.4.2 Derivative Market and its Products

***Derivative*** is a product whose value is derived from the value of an underlying asset or group of assets—a benchmark. The derivative itself is a contract between two or more parties. The most common underlying assets for derivatives are stocks, bonds, commodities, currencies, interest rates, and market indices. Derivative products are in the form of Forwards, Futures, Options and Swaps. Derivatives can trade over-the-counter (OTC) or on an exchange.

With Securities Laws (Second Amendment) Act, 1999, Derivatives has been included in the definition of Securities. The term Derivative has been defined in Securities Contracts (Regulations) Act, 1956 as:

a. a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;

b. a contract which derives its value from the prices, or index of prices, of underlying securities;

c. commodity derivatives; and

[4] https://www.sebi.gov.in/sebi_data/commondocs/foreigncos1_p.pdf
https://www.sebi.gov.in/legal/circulars/mar-2013/guidelines-for-enabling-partial-two-way-fungibility-of-indian-depository-receipts-idrs-_24379.html

d. such other instruments as may be declared by the Central Government to be derivatives;

Further Section 18A of the act provides that notwithstanding anything contained in any other law for the time being in force, contracts in derivative shall be legal and valid if such contracts are:

- Traded on a recognized stock exchange
- Settled on the clearing house of the recognized stock exchange, in accordance with the rules and bye–laws of such stock exchanges.
- Between such parties and on such term as the Central Government may, by notification in the Official Gazette specify

Forward contract is a promise to deliver an asset on a pre- determined date in future at a predetermined price. Forward contracts are non-standardised contracts which are traded in OTC[5].

A Futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Future contracts are the Exchange traded organized/standardized contracts in terms of quantity, quality (in case of commodities), delivery time and place for settlement on any date in future. The contract expires on a pre-specified date which is called the expiry date of the contract. Futures contracts are special types of forward contracts in the sense that the former are standardized exchange traded contracts.

Options give the buyer (holder) a right but not an obligation to buy or sell an asset at a predetermined price within or at end of a specified period. Options are of two types - call and put. Call Option give the buyer the right, but not the obligation, to buy a given quantity of the underlying asset, at a given price on or before a given future date. Put Option give the buyer the right, but not the obligation, to sell a given quantity of the underlying asset at a given price on or before a given date. Options are traded on stock exchanges as well as on OTC.

A swap is an agreement made between two parties, to exchange cash flows in the future, according to a prearranged formula. Swaps are, broadly speaking, series of forward contracts. Swaps help market participants manage risk associated with volatile interest rates, currency exchange rates and commodity prices etc. Swaps are mainly traded in OTC.

The two types of exchange traded derivatives instruments are futures and options. In India, futures and options are traded on equity stocks, equity indices, currency, interest rate and interest rate instruments and commodities.

[5] In case of derivatives, Over-the-counter generally indicate transaction undertaken other than Stock Exchanges and including electronic trading platform.

### 1.4.2.1 Equity Derivatives:

**Equity Derivatives** are financial instruments whose value is derived from price movements of the underlying asset, where that asset is a stock or stock index.

**Equity Index Futures and Options**: Currently in the Indian markets, future and options contract are available for trading on the benchmark indices such as BSE's SENSEX, MSEI SX40 and NSE's NIFTY 50 and sectoral indices of banks etc. SEBI has specified eligibility criteria to introduce derivatives on benchmark and non-benchmark indices.[6]

SEBI has provided the guidelines on Final Settlement Day (Expiry Day) for Equity Derivatives Contracts. The details are given below:

- Expiries of all equity derivatives contracts of an exchange will be uniformly limited to either Tuesday or Thursday.
- Every exchange will continue to be allowed one weekly benchmark index options contract on their chosen day (Tuesday or Thursday).
- Besides benchmark index options contracts, all other equity derivatives contracts, viz., all benchmark index futures contracts, non-benchmark index futures / options contracts, and all single stock futures / options contracts will be offered with a minimum tenor of 1 month, and the expiry will be in the last week of every month on their chosen day (that is last Tuesday or last Thursday of the month).
- Exchanges will now seek prior approval of SEBI for modifying the settlement day of their derivatives contracts from the one which has been existing.

Options contract for some indices are allowed up to five year's expiry cycle with quarterly and half-yearly expiries. In case the expiry day is a trading holiday; the contracts expire on the previous trading day. A new contract is introduced on the next trading day following the expiry of the near month contract. Monthly index contracts generally have 3-month expiry cycle except for the long dated options contracts which are available up to 5-year expiry cycle with quarterly expiries (March, June, Sept & Dec cycle) and half yearly expiries (Jun, Dec cycle). Generally, all option contracts with expiry of more than 9 months shall be treated as long dated/long term option contracts. A new contract is introduced on the next trading day following the expiry of the near month contract. Weekly option contracts expire on specific day of the week. A new weekly contract is introduced on the next trading day following the expiry of the respective week 's contract. All Index future and option contracts are cash settled.

[6] https://www.sebi.gov.in/legal/circulars/may-2025/measures-for-enhancing-trading-convenience-and-strengthening-risk-monitoring-in-equity-derivatives_94293.html

**Stock Futures and Options:** Individual stock futures and options on specific listed stocks are chosen by the stock Exchange based on the guidelines and criteria[7] (such as market capitalization, the median quarter sigma order size, trading volume, delivery volume etc.) defined by SEBI. All stock futures and option contracts are physically settled. All single stock futures / options contracts will be offered with a minimum tenor of 1 month, and the expiry will be in the last week of every month on their chosen day (that is last Tuesday or last Thursday of the month). Exchanges will now seek prior approval of SEBI for modifying the settlement day of their derivatives contracts from the one which has been existing. A new contract is introduced on the next trading day following the expiry of the near month contract.

### 1.4.2.2 Currency Derivatives

Currency Derivatives trading was introduced in the Indian financial markets with the launch of currency futures trading in the USD-INR pair in 2008.[8] Currently in India, currency futures contracts are traded on four INR pairs i.e., USDINR, EURINR, GBPINR and JPYINR and on three cross currency pairs i.e., EURUSD, GBPUSD and USDJPY on the recognized stock exchanges. Currency futures and options are traded on separate segment namely "Currency Derivatives Segment" of the Exchange. In case of currency futures, the underlying for USD-INR, EURINR, GBPINR and JPYINR pair would be the rate of Exchange between USD and INR, Euro and INR, Great Britain Pound and INR and Japanese Yen and INR respectively. The contract has a maximum of 12 months of trading cycle. The new contract is introduced following the expiry of the current contract. The expiry day/ last day for the trading of the monthly contract shall be two working days prior to the last business day of the expiry month at 12.30 pm. All these contracts are cash settled. The final settlement price for USDINR, EURINR, GBPINR and JPYINR is the FBIL (Financial Benchmarks India Pvt. Ltd.) reference rate. FBIL[9] is an independent benchmark administrator for interest rates and foreign exchange. The final settlement price for cross currency pairs is derived from crossing respective FCY-INR rates.

In case of currency options, monthly as well as weekly contracts are available. In case of monthly contracts, 3 serial monthly contracts followed by 3 quarterly contracts of the cycle March/June/September/December are available for trading. The expiry date is two working days prior to the last business day of the expiry month at 12.30 pm. The final settlement price is the FBIL reference rate on the date of the expiry of the contact.

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[7] https://www.sebi.gov.in/legal/circulars/aug-2024/review-of-eligibility-criteria-for-entry-exit-of-stocks-in-derivatives-segment_86373.html

[8] Currency futures were launched at the National Stock Exchange of India on August 29, 2008, and subsequently currency trading at BSE was introduced on October 1, 2008, and MSEI (earlier known as MCX-SX) on October 7, 2008.

[9] Financial Benchmark India Pvt. Ltd (FBIL) is an independent benchmark administrator for interest rates and foreign exchange.

There are weekly futures and options are also available in various Exchanges for certain currency pairs. Generally, such contracts are expired on last day of the week, i.e., on Friday at 12:30 pm. Currently, all Exchange Traded Currency Futures and Option contracts are cash settled in INR.

### 1.4.2.3 Interest Rate Derivatives

**Interest Rate Derivatives** trading was introduced with introduction of Interest rate futures contract. Interest rate option was introduced in 2019.

Interest Rate Futures (IRF) are standardized interest rate derivative contracts traded on a recognized stock exchange to buy or sell a notional security or any other interest-bearing instrument or an index of such instruments or interest rates at a specified future date, at a price determined at the time of the contract. Interest Rate Futures include Money Market Futures also. Currently Exchange traded interest rate futures are available on single government of India Securities within maturity basket of 4-8 year, 8-11 year and 11-15 years, 91-day T-Bills and Overnight MIBOR. All these contracts are currently cash settled. SEBI has also provided guidelines for introduction of future contracts on Corporate Bond Indices.

For single bond futures available on GOI securities, the lot size (i.e., the minimum amount that can be traded on the Exchange) is 2000 bonds at the rate of Rs. 100 per bond i.e., with the total face value of Rs.2,00,000. Typically, three Serial monthly contracts followed by three quarterly contracts of the cycle March/June/September/December available for single bond futures. Last trading day is the last Thursday of the expiry month. If the last Thursday is a holiday, previous trading day will be the last trading day. The contract is cash settled. The final settlement price is value weighted average price of the underlying bond based on the prices during the last two hours of the trading on NDS-OM. If less than 5 trades are executed in the underlying bond during the last two hours of trading, then FIMMDA/FBIL price shall be used for final settlement.

Interest rate options are currently available on single bond GOI securities. Typically, three Serial monthly contracts followed by three quarterly contracts of the cycle March/June/September/December available for single bond options. Last trading day is the last Thursday of the expiry month. If the last Thursday is a holiday, previous trading day will be the last trading day. These contracts are cash settled. The final settlement price is value weighted average price of the underlying bond based on the prices during the last two hours of the trading on NDS-OM. If less than 5 trades are executed in the underlying bond during the last two hours of trading, then FIMMDA/FBIL price shall be used for final settlement.

Interest rate futures and Options are traded on Currency Derivatives segment of the Exchange. Though SEBI allowed physical settlement for interest rate derivatives product, currently all Interest Rate Derivatives traded on Exchanges are cash settled.

#### 1.4.2.4 Commodity Derivatives

Commodities Derivatives are derivatives products, the price of which is derived from the underlying commodities. Commodity derivatives facilitate the trading of commodities such as gold, silver, metal, energy and agricultural goods. Commodity derivatives contract can cash settled or physically settled with actual delivery of commodity. Commodity futures and options are traded on separate segment namely "Commodity Derivatives Segment" of the Exchange.

### 1.4.3 Debt Market and its Products

Debt market mainly consists of government securities, money market instruments, bonds and debentures, which provide financing through the issuance of bonds, and enable the subsequent trading thereof. These instruments can be traded in OTC, Electronic Trading Platform or Exchange traded markets. In India, the debt market is broadly divided into two parts: government securities (G-Sec) market and the corporate bond market.

***Government Securities Market***: The Government needs enormous amount of money to perform various functions such as maintaining law and order, justice, national defense, central banking, creation of physical infrastructure etc. For this, it generates money by various ways including borrowing from banks and other financial institutions. A Government Security (G-Sec) is a tradeable instrument issued by the Central Government or the State Governments. It acknowledges the Government's debt obligation. Such securities are short term (usually called treasury bills, with original maturities of less than one year) or long term (usually called Government bonds or dated securities with original maturity of one year or more). In India, the Central Government issues both, treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called the State Government Securities (SGS). G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments.

The major investors in this market are banks, insurance companies, provident funds, mutual funds, state governments, FPIs etc.

In the primary market, Government securities & Treasury Bills are issued through auctions (yield based or price based auctions) conducted by RBI. The secondary market for G-Secs in India is very active with diverse groups of market participants. Secondary market trading mainly takes place through Negotiated Dealing System-Order Matching (NDS-OM) of RBI. G-Secs are also traded in OTC market, RBI retail direct portal and Stock Exchanges.

As per the Reserve Bank of India (Access Criteria for NDS-OM) Directions, 2025 any person/entity eligible to invest in Government securities in terms of the applicable rules/ guidelines issued by the Government of India / State Governments / the Reserve Bank, as amended from time to time shall be eligible to access NDS-OM either through direct access or through indirect access or through Stock Broker Connect, in terms of these Directions. "Stock Broker Connect" shall mean a mechanism through which a stock broker provides access to NDS-OM to its individual constituents / clients maintaining demat accounts with depositories registered with the Securities and Exchange Board of India.In order to facilitate SEBI-registered stock brokers to participate in Government Securities (G-Secs) market in the NDS-OM, SEBI has advised stock broker that they may do so under a Separate Business Unit (SBU)of the stock broking entity itself.[10]

***Corporate Bond Market***: The corporate bond or corporate debt market is a market where debt securities of corporate (non-government entities, municipal corporation etc.) such as corporate bonds, debentures etc. are issued and traded. Corporates adopt either the public offering route or the private placement route for issuing debentures/bonds. Corporate bonds are bonds issued by firms to meet their needs for expansion, modernization, restructuring operations, mergers and acquisitions. The investors in this market are banks, financial institutions, insurance companies, mutual funds, FPIs etc.
In India, corporate bonds are issued mainly on private placement basis (around 99%) and only small part of the total issuances are through public offer. With the majority of corporate debt issuances in India being private placements, SEBI vide its circular of April 21, 2016, facilitate/mandate private placement issuance through electronic book mechanism/electronic bidding platform (EBP) based on issue size, existence of issuers etc. for better and transparent price discovery. EBP guideline applicable for debt securities and non-convertible redeemable preference shares and for municipal debt securities are specified under SEBI regulations. An issuer, if desirous, may choose to access EBP platform for private placement of securitised debt instruments or security receipts or CPs or CDs. Further, issuers constituted as REITs, SM REITs and InvITs may also access the EBP platform for private placement of units of REITs, SM REITs and InvITs.[11]

Corporate Bond secondary market is mainly OTC market, where the trades are negotiated between the participants on phone or through intermediaries. The exchanges have a corporate bond reporting platform, in which all regulated entities need to report OTC corporate bond trades within stipulated time. The Exchanges in early 2020 have launched Request for Quote (RFQ) Platform for execution and settlement of trades which will allow

[10]https://www.sebi.gov.in/legal/circulars/feb-2025/facilitation-to-sebi-registered-stock-brokers-to-access-negotiated-dealing-system-order-matching-nds-om-for-trading-in-government-securities-separate-business-units-sbu-_91764.html
[11]https://www.sebi.gov.in/legal/circulars/may-2025/review-of-provisions-pertaining-to-electronic-book-provider-ebp-platform-to-increase-its-efficacy-and-utility_94020.html

market participants to transact in debt securities. The RFQ Platform provides market participants range of options to seek a quote and to respond to a quote, while keeping an audit trail of all the interactions i.e. quoted yield, mutually agreed price, deal terms etc. This has brought pre trade transparency in the transactions of eligible debt securities. RFQ facilitate participant to negotiate various terms of transaction through screen based system. Corporate bonds are also traded on Stock Exchanges. The platform allows regulated entities to transact through brokers or directly while other entities have an option to transact through brokers.

**Online Bond Platform**: "Online Bond Platform" means any electronic system, other than a recognised stock exchange or an electronic book provider platform, on which the debt securities which are listed or proposed to be listed, are offered and transacted. "Online bond platform provider" (OBPPs) means any person operating or providing an online bond platform. OBPs provide an avenue for investors, particularly non-institutional investors, to access the bond market. SEBI has mandated OBPPs to register with SEBI as a stockbroker in the debt segment of a recognized stock exchange.

### 1.4.4 Other Asset Classes

***Real Estate Investment Trusts (REIT)***[12] are trusts registered with SEBI that invest in commercial real estate assets. "REIT" or "Real Estate Investment Trust" means a person that pools Rs. 50 crores or more for the purpose of issuing units to at least 200 investors so as to acquire and manage real estate asset(s) or property(ies), that would entitle such investors to receive the income generated therefrom without giving them the day-to-day control over the management and operation of such real estate asset(s) or property(ies). REIT assets" means real estate assets and any other assets held by the REIT, on a freehold or leasehold basis, whether directly or through a holding company and/or a special purpose vehicle. SEBI (Real Estate Investment Trusts) Regulations, 2014, laid down framework for REITs. The SEBI (Real Estate Investment Trusts) Regulations, 2014 specifies conditions regarding issuance and allotment of units. Few details are given below:

A REIT shall make an initial offer of its units by way of public issue only. Any subsequent issue of units by the REIT may be by way of follow-on offer, preferential allotment, qualified institutional placement, rights issue, bonus issue, offer for sale or any other mechanism and in the manner as may be specified by SEBI. The value of the assets owned or proposed to be owned by a REIT coming out with an initial offer will not be less than Rs. 500 crore and the minimum offer size will not be less than Rs.250 crore. The minimum number of unit

[12]Candidates are advised to go through the SEBI Circular dated November 28,2025 for reclassification of REITS as equity related instrument: https://www.sebi.gov.in/legal/circulars/nov-2025/reclassification-of-real-estate-investment-trusts-reits-as-equity-related-instruments-for-facilitating-enhanced-participation-by-mutual-funds-and-specialized-investment-funds-sifs

holders other than sponsor(s), its related parties and its associates forming part of public which shall be not less than two hundred. The maximum subscription from any investor other than sponsors, its related parties and its associates shall not be more than 25 percent of total unit capital. The minimum subscription from any investor in initial and follow-on public offer shall fall in range of Rs. 10 thousand to Rs. 15 thousand rupees. The units will be mandatorily listed on the stock exchange. The units of the REIT listed in recognized stock exchanges shall be traded, cleared and settled in accordance with the bye-laws of concerned stock exchanges and such conditions as may be specified by the SEBI. Trading lot for the purpose of trading of units of the REIT shall consist of one unit.

SM REITs were introduced by SEBI in 2024 and differs from traditional or "normal" REITs primarily in asset size, minimum investment requirements, and investment structure. Unlike regular REITs, a single SM REIT can launch multiple schemes, each holding different assets, similar to mutual funds. The minimum subscription amount is Rs. 10 lakhs.

***Infrastructure Investment Trusts (InvIT)*** are trusts registered with SEBI that invest in the infrastructure sector. SEBI (Infrastructure Investment Trusts) Regulations, 2014, laid down framework for InvITs. The SEBI (Infrastructure Investment Trusts) Regulations, 2014 specifies conditions regarding issuance and allotment of units. The InvIT can raise funds through public issue and/or through private placement. The value of InvIT assets shall not be less than Rs. 500 crore and the offer size shall be of atleast Rs. 250 crores.

If the InvIT raises funds by public issue it shall be by way of initial public offer. No InvIT shall raise funds through public issue if any subordinate units have been issued and are outstanding. Any subsequent issue of units after IPO may be by way of follow-on offer, preferential allotment, qualified institutional placement, rights issue, bonus issue, offer for sale or any other mechanism and in the manner as may be specified by SEBI. The minimum subscription amount from any investor in initial and follow-on offer shall fall within the range of Rs. 10,000 to Rs. 15,000. The maximum subscription from any investor other than sponsors, its related parties and its associates shall not be more than 25 percent of total unit capital. The InvIT shall refund money in case the number of subscribers to the initial offer forming part of public is less than twenty or fails to collect subscription of at least 90% of the issue size.

In case InvIT raises fund by way private placement, then it shall be do it through placement memorandum and from institutional investor or body corporate only, whether Indian and foreign. The minimum investment from any investor should be of rupees 25 Lakhs. The maximum subscription from any investor other than sponsors, its related parties and its associates shall not be more than 25 percent of total unit capital. The placement is from not less than five and not more than one thousand investors. It shall be mandatory for units of all InvITs to be mandatorily listed on a recognized stock exchange having nationwide trading terminals, whether publicly issued or privately placed. The units of the InvIT listed in the designated stock exchanges shall be traded, cleared and settled in accordance with

the bye-laws of designated stock exchanges and such conditions as may be specified by the SEBI. In case of private placement, trading lot for the purpose of trading of units on the designated stock exchange shall Rs. 25 lakhs. In case of public issue, trading lot for the purpose of trading of units on the designated stock exchange shall consist of one unit.

***Sovereign Gold Bond Scheme (SGB)*** was launched in 2015 to provide an alternative way for investors to take exposure to gold as an investment. SGBs are government securities denominated in grams of gold. The bonds are issued in denomination of one gram of gold and in denominations thereof. The tenor of the bond is 8 years. Each bond investor buys the bonds in Indian rupees and on redemption are paid the maturity value also in Indian rupees. The units (grams) of gold bought by the investor and represented by the bonds is protected. The value of the bond will reflect the price of gold. On maturity the value of the bond may be higher or lower depending upon the prevailing price of gold. The bonds bear an interest rate (currently 2.50% per annum) on the initial investment and is paid semi-annually to the account of the bond holder. Investors can apply for the bond when the issue of each tranche is open. The bonds are available for investment by resident individuals, HUFs, Trusts, Universities, Charitable Trusts and others. The bonds can be held in physical form or in dematerialized form. The bond is tradable on stock exchanges if held in dematerialized form.

**Right Entitlement Trading**

Rights Entitlement is the right given to eligible shareholders to apply for new shares in a rights issue, in proportion to their existing shareholding. Rights entitlements are mandatorily credited to the demat accounts of eligible shareholders as on the record date in an electronic, dematerialised form. A separate ISIN (International Securities Identification Number) is created for the REs to distinguish them from the main shares. REs are traded on the secondary market platform of stock exchanges (like the NSE and BSE) similar to regular equity shares. This allows existing shareholders to sell their entitlements if they do not wish to subscribe to the additional shares, or for other investors (even those not existing shareholders) to buy them. Investors who hold REs (either original allottees or those who purchased them from the market) must apply for the underlying shares through the mechanism specified by SEBI from time to time.

## 1.5 International Financial Services Centres (IFSC)

An International Financial Services Centre (IFSC) caters to customers outside the jurisdiction of the domestic economy. These centres are 'international' in the sense that they deal with the flow of finance and financial products/services across borders which includes banking, insurance, asset management, and most importantly, a well-structured and fully developed capital market for debt, equities, commodities as well as derivatives. The first IFSC in India

has been set up at GIFT City, Gandhinagar, Gujarat. An IFSC is thus a jurisdiction that provides world class financial services to non-residents and residents, to the extent permissible under the current regulations, in a currency other than the domestic currency (Indian rupee) of the location where the IFSC is located.

IFSC at GIFT, Gandhinagar is a deemed foreign territory dealing in foreign currency governed by statutory authority, International Financial Services Centers Authority (IFSCA) established in 2020. The entities in IFSC are recognized as non-resident entity under the FEMA regulations of Reserve Bank of India. Units operating within the IFSC enjoy significant tax incentives, including a 10-year[13] income tax holiday within a 15-year block. Investors benefit from exemptions on capital gains tax, Securities Transaction Tax (STT), and GST on offshore services.

"Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme" (the Direct Listing Scheme) is specified in Schedule XI of Foreign Exchange Management (Non-debt Instruments) Rules, 2019. The Scheme provides an overarching framework for issuing and listing of equity shares of **public Indian companies (both listed as well as unlisted)** on international exchanges. Prior to this, Indian companies were not allowed to issue or list equity shares abroad. The direct listing of equity shares of Indian companies on the International Exchanges in GIFT IFSC will be in accordance with IFSCA Act, 2019 and Rules and Regulations notified thereunder, including the IFSCA (Issuance and Listing of Securities) Regulations, 2021 (ILS Regulations). The ILS Regulations provide the regulatory framework for initial listing, disclosure requirements, continuous listing obligations etc. for listing companies on the International Exchanges in GIFT IFSC. While the framework is already operational for unlisted public companies, the specific, detailed operational guidelines for companies already listed in India are still to be issued by SEBI.
IFSCA (International Financial Services Centres Authority) has issued operating guideline to enable the Bullion Exchange, Bullion Clearing Corporation, Bullion Depository, Vault Manager in as IFSC to operationalize these activities as per IFSCA (Bullion Exchange) Regulations, 2020.

As per the SEBI International Financial Services Centres (IFSC) guidelines, 2015, the stock exchanges operating in IFSC was permitted dealing in following types of securities and products, with a specified trading lot size on their trading platform subject to prior approval of SEBI, viz.,

- Equity shares of a company incorporated outside India;

[13] In union budget of 2026, the income tax holiday period for GIFT city is increase to 20% within 25-year blocked.

- Depository receipt(s);
- Debt securities issued by eligible issuers;
- Currency and interest rate derivatives;
- Index based derivatives;
- Commodity derivatives;
- REITs and InvITs by whatever name called in permissible jurisdictions;
- And any other securities as may be specified by SEBI.

Currently NSE and BSE both have exchanges at IFSC and offer various products for trading viz., Index derivatives, Stock Derivatives, Currency Derivatives, Commodity Derivatives and Debt Securities.

As per SEBI (International Financial Services Centres) Guidelines, 2015, only the following persons can deal in securities listed in IFSC:

- A person not resident in India;
- A non-resident Indian;
- A financial institution resident in India who is eligible under FEMA to invest funds offshore, to the extent of permitted outward investment;
- A person resident in India who is eligible under FEMA, to invest funds offshore, to the extent allowed under the Liberalized Remittance Scheme of Reserve Bank of India, subject to a minimum investment as specified by the Board from time to time.

In order to facilitate SEBI[14] registered stock brokers to undertake securities market related activities in GIFT-IFSC, SEBI has done away with the requirement of obtaining specific approval from SEBI. Stock brokers proposing to undertake securities market related activities in GIFT-IFSC are permitted to do so under a Separate Business Unit (SBU) of the stock broking entity itself. These activities can also be carried out if the branch qualifies as an SBU. Further, existing practice of carrying out securities market related activities in GIFT-IFSC through a subsidiary is also allowed.

[14]https://www.sebi.gov.in/legal/circulars/may-2025/measure-for-ease-of-doing-business-facilitation-to-sebi-registered-stock-brokers-to-undertake-securities-market-related-activities-in-gujarat-international-finance-tech-city-international-financia-_93775.html

**Chapter 1: Sample Questions**

1. Which of the following best describes the term “Private Placement”?

(a) Issue made to all investors in the Indian securities market.
**(b) Issue made to select group of people.**
(c) Issue made to those investors who already hold shares of the company.

2. State which of these statements is true?
**(a) Call Option gives the buyer the right but not the obligation to buy the underlying asset.**
(b) Call Option gives the buyer the right but not the obligation to sell the underlying asset.
(c) Put Option gives the buyer the right but not the obligation to buy the underlying asset.

3. The fractional ownership in a company is represented by which of the following?
**(a) Equity Shares**
(b) Debentures
(c) Bonds

4. _____ Instruments are not allowed to be traded on IFSCA?
(a) Equity shares of a company incorporated outside India
**(b) Equity shares of a Private Indian Companies**
(c) Currency and interest rate derivatives

# CHAPTER 2: MARKET PARTICIPANTS IN THE SECURITIES MARKET

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Different types of securities market participants
- Different types of investors based on their investment objectives
- Issuer and regulations related to issuer
- Role of different kinds of intermediaries in the securities markets
- Regulatory framework of securities and some key regulations

## 2.1 Introduction

As already discussed in the previous chapter, in every economic system, there are savers (who are surplus-generators) and there are spenders (deficit-generators). Securities market provides a platform for savers (i.e., Investors) to place their surplus funds in financial claims or securities at the disposal of the spenders (i.e., Issuers) and in turn get benefits such as interest, dividend, capital appreciation, bonus etc. These investors and issuers of financial securities constitute two important elements of the securities markets.

Another important element of the markets are the intermediaries who act as conduits between the investors and issuers. Regulatory bodies, which regulate the functioning of the securities markets, constitute another significant element of securities markets. The process of mobilization of resources is carried out under the supervision and overview of the regulators. The regulators develop fair market practices and regulate the conduct of issuers of securities, investors and the intermediaries. They are also in-charge of protecting the interests of the investors. The regulator ensures a high service standard from the intermediaries and supply of quality securities and non-manipulated demand for them in the market.

*Thus, the important participants of securities markets are the investors, the issuers, the intermediaries and regulators.* We now discuss these different participants in detail in the following sections.

## 2.2 Investors

An investor is the backbone of the securities market in any economy as he is the one giving surplus resources for funding to companies (for their set-up or for expansion plans) in return for financial gains. Investors in securities market (based on primary public issuance categorization) can be broadly classified into Retail Individual Investors, Institutional Investors and Non-institutional investors (NII).

***Retail Individual Investors*** means an individual investor (Resident Indians, non-resident Indians, HUF) who applies or bids for specified securities for a value of not more than two lakhs rupees;

***Institutional Investors*** comprises domestic financial institutions (DFIs), banks, insurance companies, mutual funds, and Foreign Portfolio Investors (a FPI is an entity established or incorporated outside India that proposes to make investments in India) and any other entity specified by SEBI as an Institutional.

SEBI (Foreign Portfolio Investors) Regulations, 2019, specifies the categories of FPI which are as given below:

| **FPI Category** | **Type of Entity** |
|---|---|
| Category 1 | (i) Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations etc.;<br>(ii) Entities controlled or at least 75% directly or indirectly owned by such Government and Government related investors<br>(iii) Pension funds and university funds;<br>(iv) Appropriately Regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker dealers and swap dealers;<br>(v) Entities from the Financial Action Task Force (FATF) member countries with certain condition<br>(vi) An entity (A) whose investment manager is from the Financial Action Task Force (FATF) member country and such an investment manager is registered as a Category I foreign portfolio investor; or (B) which is at least seventy-five per cent owned, directly or indirectly by another entity, eligible under (ii), (iii)and (iv) and such an eligible entity is from a Financial Action Task Force member country: |
| Category 2[15] | i) Appropriately Regulated funds not eligible as Category-I foreign portfolio investor;<br>ii) Endowments and foundations;<br>iii) Charitable organizations;<br>iv) Corporate bodies;<br>v) Family offices;<br>vi) Individuals; |

[15] Category-2 FPIs who are corporate bodies, individual and family offices are treated as non-institutional

| | |
|---|---|
| | vii) Regulated entities investing on behalf of their client,<br>viii) Unregulated funds in the form of limited partnership and trusts |

Non-Institutional investor means any investor other than retail individual investor and institutional investor such as Family offices, corporates, partnership firms etc.

**Accredited Investors**[16]

The concept of a class of investors who have an understanding of various financial products and the risks- returns associated with them and therefore, are able to take informed decisions regarding their investments, is recognized by many securities and financial market regulators around the globe. These investors are typically termed as Accredited Investors or Qualified Investors or Professional Investors. SEBI has introduced concept of Accredited Investors in Indian Market. Given below some of the details of accredited investor:

- Eligibility
    - Individuals, HUFs, Family Trusts and sole proprietorships, which meet the criteria as under:
        - (i) Annual Income >= INR 2 Crore; OR
        - (ii) Net Worth >= INR 7.5 Crore, out of which at least INR 3.75 Crore is in the form of financial assets; OR
        - (iii) Annual Income >= INR 1 Crore+ Net Worth >= INR 5 Crore, out of which at least INR 2.5 Crore is in the form of financial assets;
    - Partnership Firms set up under the Indian Partnership Act, 1932 in which each partner independently meets the Accredited Investor criteria for individuals
    - Trusts (other than family trusts) Assets under Management are greater than or equal to INR 50 Crore.
    - Body corporate with net worth greater than or equal to INR 50 Crore.
    - The eligibility of foreign investors to be accredited shall be determined on the basis of the rupee equivalent of their income and/ or net worth as applicable.
    - The Central Government and the State Governments, developmental agencies setup under the aegis of the Central Government or the State Governments, funds setup by the Central Government or the State Governments, qualified institutional buyers as defined under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, Category I foreign portfolio investors, sovereign wealth funds and multilateral agencies and any other entity as may

[16] https://www.sebi.gov.in/sebi_data/meetingfiles/jul-2021/1626434827210_1.pdf, https://www.sebi.gov.in/legal/circulars/aug-2021/circular-on-modalities-for-implementation-of-the-framework-for-accredited-investors_52116.html
https://www.sebi.gov.in/legal/circulars/dec-2023/simplification-of-requirements-for-grant-of-accreditation-to-investors_79990.html

be specified by the SEBI from time to time, shall deemed to be an accredited investor and may not be required to obtain a certificate of accreditation.

- Subsidiaries of depositories and stock exchanges or any other institutions which eligibility criteria specified by SEBI will act as "Accreditation Agency" and can issue an accreditation certificate to such investors.
- The Accreditation agencies shall grant accreditation solely based on the KYC and the financial information of the applicants
- Validity of Accreditation
    - If the applicant meets the eligibility criteria for preceding one financial year, the accreditation certificate issued shall be valid for a period of two years from the date of issuance.
    - If the applicant meets the eligibility criteria in each of the preceding two financial years, the accreditation certificate issued shall be valid for a period of three years from the date of issuance.
    - If the applicant is a newly incorporated entity, which does not have financial information for the preceding financial year but meets the applicable net-worth criteria as on the date of application, the accreditation certificate issued shall be valid for a period of two years from the date of issuance.
- Certain benefits for accredited investors
    - To participate in investment products with an investment amount lesser than the minimum amount mandated in the respective Regulations ("lower ticket size").
    - Relaxation from regulatory requirements applicable to investment products, such as prudential norms, investment conditions, filings with SEBI, frequency of Audit/ valuation/ reporting, etc. ("regulation-light framework").
    - To participate in investment products designed and offered exclusively to Accredited Investors.

**Market Maker**

Market makers provide liquidity to facilitate efficiency in the functioning of the financial markets. Market maker mainly operates under the guidelines provided by SEBI or by Exchanges. SEBI has issued detailed guidelines for "Liquidity Enhancement Scheme in the Equity Cash and Equity Derivatives Segments"[17]. It has also provided guidelines for market maker vide circular dated January 20, 2000. In case of regular cash market and derivatives market liquidity scheme is mainly introduced by the Exchanges. However, for Small and Medium Enterprise (SME) Exchange, market making has been made mandatory in respect of all scrips listed and traded on SME Exchange.

[17] SEBI circular CIR/MRD/DP/14/2014 dated April 23, 2014.

The main responsibility of market maker is to provide two-way (buy as well as sell) quotes on a continuous basis with certain minimum amount and reasonable bid-ask spread.

## 2.3 Issuers

The public and private sector enterprises, banks and other financial institutions tap the securities market to finance their capital expansion and growth plans. Even mutual funds which are an important investment intermediary, mobilizes the savings of the small investors. Funds can be raised in the primary market from the domestic market as well as from international markets. In the domestic market, issuer can raise funds through financial securities like equity shares, preference shares, Debentures, Bonds etc. They can raise funds through public offer and/or through private placement.

Indian companies can also raise resources from international capital markets[18] through Global Depository Receipts (GDRs)/American Depository Receipts (ADRs), Foreign Currency Convertible bonds (FCCBs) and External Commercial Borrowings (ECBs) including Masala Bonds. These methods are regulated primarily by the Reserve Bank of India (RBI) under the Foreign Exchange Management Act (FEMA) and, for equity instruments, by the Securities and Exchange Board of India (SEBI). To learn more about the different international market instruments for raising capital from overseas market please see Box 2.1.

**Box 2.1: Instruments for raising capital from overseas markets**

**Global Depository Receipts (GDRs)** is a negotiable financial instrument that is issued by a foreign depository bank other than the US representing a specified number of shares of a foreign company's stock. GDR are generally traded in European Stock Exchanges.

**American Depository Receipts (ADRs)** An American depositary receipt (ADR) is a negotiable certificate issued by a U.S. depository bank representing a specified number of shares of a foreign company's stock. The ADR trades on U.S. stock markets similar to any domestic shares.

**Foreign Currency Convertible Bonds (FCCBs)** are bonds issued by Indian companies and subscribed to by a non-resident in foreign currency. They carry a fixed interest or coupon rate and are convertible into a certain number of ordinary shares at a predetermined price.

**External Commercial Borrowings (ECBs)** are commercial loans (in the form of bank loans, buyers credit, suppliers credit, securitized instruments, floating rate notes and fixed rate bonds) availed from any internationally recognized source such as bank, export credit agencies, suppliers of equipment, foreign collaborators, foreign equity holders and international capital market. Indian companies have preferred this route to raise funds as the cost of borrowing is low in the international markets.

**Masala Bonds** are rupee-denominated bonds issued outside India by Indian entities. They are debt instruments which help to raise money in local currency from foreign investors.

**Overseas Listing**: Recent government and SEBI regulations permit certain Indian companies to list their securities directly on overseas stock exchanges, providing a more direct route to access foreign equity markets.

[18] The 1991 reforms allowed Indian companies to raise resources by way of equity issues in the international markets.

Foreign companies can raise capital from Indian markets. They can issue IDR (Indian Depository Receipts). This will be in rupee terms. Standard Chartered Bank is the first entity to raise capital through issuing IDR.

***Regulations for Issuers:***

To raise resources, issuers have to adhere to different SEBI regulations which have been briefly discussed here:

- *SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*

SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 hereinafter referred to as ICDR Regulations lays down general conditions for capital market issuances like public and rights issuances; eligibility requirements; general obligations of the issuer and intermediaries in public and rights issuances; regulations governing preferential issues, qualified institutional placements and bonus issues by listed companies; issue of IDRs etc. ICDR Regulations also have detailed requirements laid out with respect to disclosure and process requirements for capital market transactions by listed and to be listed companies. While the eligibility and disclosure obligations are applicable to the Issuer, in capital market transactions, the role of the merchant banker/ lead manager/ book runner is extremely important since they are registered entities with SEBI appointed by the issuer to manage the issue and in case of book built issue the lead manager act as Book Running Lead Manager (BRLM) for the purpose of book running

- *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*

Issuer or the issuing company desirous of listing its securities on a recognized stock exchange shall execute a listing agreement with such stock exchange in terms of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. As per the regulations, the company is required to obtain 'in-principle approval for listing from the exchanges having nationwide trading terminals where it is listed, before issuing further shares or securities. Where the company is not listed on any exchange having nationwide trading terminals, the in-principle approval is required from all the stock exchange(s) in which the securities of the issuer are proposed to be listed. Where the securities are listed on recognized stock exchange(s) having nationwide trading terminals as well as on the recognized stock exchange(s) not having nationwide trading terminals, from all recognized stock exchange(s) having nationwide trading terminals. The regulation is also providing various disclosures and obligations for listed entities.

Other important regulations include, SEBI (Issue and listing of securitized debt instrument and security receipt) Regulations, 2008, Securities and Exchange Board of India (Issue and Listing of Municipal Debt Securities) Regulations, 2015, Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021 etc.

## 2.4 Market Structure and Participants

Intermediation is the process of enabling the saver or buyer of securities (through information and facilitation) to buy or sell the securities and help them acquire all the rights related to the security.

The intermediaries play a very important role in the securities market; they put together the demands of the buyers with the offers of the security sellers. A large variety and number of intermediaries provide intermediation services in the Indian securities markets.

### 2.4.1 Market Infrastructure Institutions (Stock Exchange, Clearing Corporations and Depositories)

Stock exchanges, depositories and clearing corporations are collectively referred to as securities Market Infrastructure Institutions (MIIs).

**Stock Exchanges**

The stock Exchanges provide a trading platform where the buyers and sellers (investors) can meet to transact in securities. Earlier investors and stock-brokers met in the trading hall or the "Ring" of the Stock Exchanges to transact in stocks, whereas in the modern world, on-line trading takes through computers connected through VSATs, leased lines and Internet.

The Securities Contract (Regulation) Act, 1956 (SCRA) defines 'Stock Exchange' as *(a) anybody of individuals, whether incorporated or not, constituted before corporatization and demutualization under sections 4A and 4B, or (*b*) a body corporate incorporated under the Companies Act, 1956 (1 of 1956) whether under a scheme of corporatization and demutualization or otherwise, for the purpose of assisting, regulating or coordinating the business of buying, selling or dealing in securities.*

Typical functions of Stock Exchanges are:

- To provide the trading platform
- Dissemination of information
- Investor education, awareness and protection
- Facilitate redressal mechanism
- Surveillance and Investigation
- Listing of securities and monitoring compliance of listed companies
- Inspection and monitoring of member compliance

**Clearing Corporation**

Securities Contract (Regulation) (Stock Exchange and Clearing Corporations) Regulations 2018, defines Clearing Corporation as an entity that is established to undertake the activity of clearing and settlement of trades in securities or other instruments or products that are

dealt with or traded on a recognized stock exchange and includes a clearing house and a limited purpose clearing corporation (as specified under Chapter IV- A of SECC regulation).

A Clearing Corporation performs three main functions, namely: **clearing** and **settlement** of all transactions executed in the stock market (i.e., completes the process of receiving and delivering shares/funds to the buyers and sellers in the market) and carrying out **risk management.** The Clearing Corporation acts as a central counterparty i.e., it provides financial guarantee for all transactions executed on the Exchange. This process is called novation.

**Important Terminologies pertaining to clearing corporations**

**Pay-In** is a process whereby a Clearing Member and Custodian (in case of Institutional deals) bring in money and/or securities to the Clearing House/ Corporation. This forms the first phase of the settlement activity.

**Pay-Out** is a process where the Clearing House/ Corporation pays money or delivers securities to the Clearing Member and Custodians. This is the second phase of the settlement activity.

**Depository**

A "Depository" is an entity facilitating holding securities in electronic form and enables transfer of securities by book entry. The main objective of depository is to provide maintenance of ownership or transfer records of securities in an electronic book entry form resulting in paper-less trading rather than paper-based trading and to ensure transferability of securities with speed, accuracy and safety.

As per the Depositories Act, 1996, a 'depository' means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);"

There are two Depositories in India, Central Depository Services Limited (CDSL) and National Securities Depository Limited (NSDL), which were established under the Depositories Act 1996, for the purpose of facilitating dematerialization of securities and assisting in trading of securities in the dematerialized form. The Depository provides its services to clients through its agents called depository participants (DPs). These agents are appointed by the depository with the approval of SEBI. According to SEBI regulations, Banks, Financial Institutions, NBFCs, Clearing Corporation, Registrar and Transfer Agents, Custodian of Securities, State Financial Corporation and SEBI registered trading members can become DPs. Besides providing custodial facilities and dematerialization, depositories offer various

transactional services to its clients to effect buying, selling, transfer of shares etc. Through a system of paperless securities, depositories have facilitated smooth securities market operations for Stock Exchanges, clearing houses/corporations, stock broking firms, equity issuing companies, share transfer agents etc.

### 2.4.2 Market Participants

#### 2.4.2.1 Trading Member /Clearing Member

An important constituent of the securities market is a trading member/ stock broker[19] who is a member of the stock exchange. A trading member is allowed to execute trades on his own account as well as on account of his clients. A trading member can be an individual (sole proprietor), a partnership firm, Limited Liability Partnership, Corporate or a bank who is a member of a Stock Exchange[20]. Clearing Members have clearing and settlement rights in any recognised clearing corporation. Clearing Member help in clearing of the trades of their clients. In India, investors cannot access the Exchange platform directly. They have to compulsorily trade through registered stock brokers/trading member of the Exchanges. Hence, stock brokers/trading members are one of the important intermediaries of securities market.

Based on trading and clearing rights membership can be classified as; only trading member, trading cum self-clearing member, trading cum clearing member and professional clearing member.

**Only trading member** category of membership entitles allow to execute trades on his own account as well as on account of his clients but, clearing and settlement of trades executed through the trading member would have to be done through a Trading-cum Clearing Member or Professional Clearing Member of the Clearing Corporation. “Only trading member” does not have clearing and settlement rights.

**Trading cum Self-clearing member**: They have trading as well clearing rights. They clear and settle trades executed by them only, either on their own account or on account of their clients but not for custodian participants.

**Trading member-cum-clearing member**: They have trading as well clearing rights. They clear and settle their own trades as well as trades of other trading members and custodial participants.

[19] Stock broker" means a person having trading rights in any recognised stock exchange and includes a trading member;
[20] Banks are permitted to become member of the currency derivative segment of recognized stock Exchanges subject to fulfillment of minimum prudential requirements.

**Professional clearing member**: They have only clearing rights and do not have trading rights. They clear and settle trades executed by trading members and custodian participants. SEBI registered custodian and Banks recognized by clearing corporations are eligible to become PCM subject to fulfilling the prescribed criteria.

**Custodians**

Custodian means any person/entity who carries on or proposes to carry on the business of providing custodial service. Custodians are also clearing members like PCMs but not trading members. They settle trades on behalf of the clients of the trading members, when a particular trade is assigned to them for settlement. The custodian is required to confirm whether he is going to settle that trade or not.

- **Registration of Stock Broker**

As per SEBI (Stock Brokers) Regulations, 2026 (erstwhile SEBI {Stock Brokers} Regulation 1992), if a new entity desires to register as a stock broker or clearing member with any stock exchange or clearing corporation, as the case may be, then the entity shall apply to SEBI through the respective stock exchange or clearing corporation in the manner prescribed in the Stock Broker Regulations 2026.

The entity shall be issued one certificate of registration by SEBI, irrespective of the stock exchange(s) / clearing corporation(s) or number of segment(s). A stock broker registered with the SEBI may operate in any recognised stock exchange or any segment of the recognised stock exchange subject to the approval of such recognized stock exchange. A stock broker registered with the Board does not need a separate registration to act as a clearing member in any segment of the clearing corporation subject to the approval of such clearing corporation. A clearing member registered with the Board does not need a separate registration to act as a stock broker in any segment of the recognised stock exchange subject to the approval of such recognized stock exchange.

Further SEBI regulation has specified segment specific net worth (including computation methodology of net worth) and deposit requirement. Regulation also specified fees for trading members and clearing member which they have to pay to SEBI. The membership of each segment of the Exchange is separate from the membership of the other segments of the Exchange. The stock broker shall have such net worth and shall deposit with the stock exchange/clearing corporation such sum as may be specified by the SEBI/ stock exchange/clearing corporation from time to time.

The admission as a trading member on the Stock Exchanges is based on the various criteria like age, capital adequacy, financial track record, education, experience and fulfillment of criteria of “fit & proper person” as laid down in the SEBI (Intermediaries) Regulations, 2008.

The Exchanges may stipulate additional requirements over and above the SEBI prescribed rules.

A. Base Minimum Capital (BMC)

BMC is the deposit given by the member of the exchange against which no exposure for trades is allowed. The BMC is maintained based on risk profile of the member. The Base Minimum Capital is discussed in detail in Section 4.1.1.4 of this workbook.

B. Eligibility Criteria

Eligibility criteria for membership is subject to the regulatory norms and provisions of SEBI and as provided in the Rules, Regulations, Byelaws and Circulars of the Exchanges. Securities Contracts (Regulation) Rules, 1957 has provided details of qualifications for membership of a recognized stock exchange: -

| ***Individual trading membership*** | |
|---|---|
| Age | Minimum Age: 21 years |
| Status | Indian Citizen |
| Education | At least HSC or Equivalent qualification |
| Experience | Applicant should have an experience of not less than two years as a partner with, or an authorized assistant or authorized remisier or apprentice to a member. |

| ***Partnership Firms registered under the Indian Partnership Act, 1932*** | |
|---|---|
| Where the applicant is a partnership firm, the applicant shall identify a Dominant Promoter Group as per the norms of the Exchange at the time of making the application. Any change in the shareholding of the partnership firm including that of the said Dominant Promoter Group or their sharing interest shall be effected only with the prior permission of Exchange/SEBI. | |
| Age | Minimum Age of designate partner: 21 years |
| Status | Registered Partnership firm under Indian Partnership Act, 1932 |
| Designated Partners | Identify at least two partners as designated partners who would be taking care of the day to day management of the partnership |
| Education | Designated Partners should be at least HSC or equivalent qualification |
| Designated Partners Experience | Should have a minimum of 2 years' experience in an activity related to dealing in securities or as portfolio manager or as investment consultant or as a merchant banker or in financial services or treasury, broker, authorized agent or authorized clerk or authorized representative or remisier or apprentice to a member of a recognized stock exchange, dealer, jobber, market maker, or in any other manner in dealing in securities or clearing and settlement thereof. |
| Dominant Promoter Norms | Identify partner's sharing interest as per Exchange DPG norms |

| ***Limited Liability Partnership*** | |
|---|---|
| A Limited Liability Partnership as defined in the Limited Liability Partnership Act, 2008 (6 of 2009), shall be eligible to be admitted as a member of a Stock Exchange if, such 'limited liability partnership' undertakes to comply with such financial requirements and norms as may be specified by the SEBI for the registration of such limited liability partnerships under sub-section (1) of section 12 of the SEBI Act, 1992 (15 of 1992);<br><br>The designated partners of the 'limited liability partnership' are not disqualified from being members of a stock exchange under sub-rule (1) of rule 8 [except sub-clauses (b) and (f) thereof] or sub-rule (3) of rule 8 [except sub-clauses (a) and (f) thereof] of the Securities Contracts (Regulation) Rules, 1957 and the designated partners of the 'limited liability partnership' had not held the offices of Directors in any company or body corporate or partner in any firm or 'limited liability partnership', which had been a member of the stock exchange and had been declared defaulter or expelled by the stock exchange. | |
| Status | Registered Limited Liability Partnership under Limited Liability Partnership Act, 2008 |
| Designated Partners | Identify at least two partners as designated partners who would be taking care of the day to day management of the limited liability partnership |
| Age | Minimum age of designated partner(s) : 21 years |
| Designated Partners Education | Designated Partners should be at least HSC or equivalent qualification |
| Designated Partners Experience | Should have a minimum of 2 years' experience in an activity related to dealing in securities or as portfolio managers or as investment consultants |
| Dominant Promoter Norms | Identify partner's sharing interest as per Exchange DPG norms |

| ***Corporations / Companies /Institutions*** | |
|---|---|
| A Company as defined in the Companies Act, 2013 (1 of 2013), shall be eligible to be admitted as a member of a Stock Exchange provided: such company is formed in compliance with the provisions of Section 12 of the said Act; it undertakes to comply with such other financial requirements and norms as may be specified by the SEBI for the registration of such company under sub-section (1) of section 12 of the SEBI Act, 1992 (15 of 1992);<br><br>The directors of such company are not disqualified for being members of a stock exchange under clause (1) of rule 8 [except sub-clauses (b) and (f) thereof] or clause (3) of rule 8 [except sub-clauses (a) and (f) thereof] of the Securities Contracts (Regulation) Rules, 1957 and the directors of the company had not held the offices of the directors in any company which had been a member of the stock exchange and had been declared defaulter or expelled by the stock exchange. | |
| Status | Corporate registered under The Companies Act, 2013 (Indian) |
| Minimum Paid up Equity Capital | As specified from time to time (Currently 30 lakhs) |
| Designated Directors | Identification of at least two directors as designated directors who would be managing the day to day trading operations |

| | |
|---|---|
| Age | Minimum age of designated director(s) : 21 years |
| Education | Each of the Designated Directors should be at least HSC or equivalent qualification |
| Designated Directors Experience | Should have a minimum of 2 years' experience in an activity related to dealing in securities or as portfolio manager or as investment consultant or as a merchant banker or in financial services or treasury, broker, authorised agent or authorised clerk or authorised representative or remisier or apprentice to a member of a recognised stock exchange, dealer, jobber, market maker, or in any other manner in dealing in securities or clearing and settlement thereof. |
| Dominant Promoter Norms | Identify dominant group as per Exchange DPG norms |

C. Other Criteria:

While giving registration as stock broker, SEBI will also examine infrastructure facility, experience of directors, disciplinary proceeding against key management person etc. At any point of time the applicant has to ensure that either the proprietor/one designated director/partner or the Compliance Officer of the applicant entity should be meeting the certification requirements as specified by SEBI or the Stock Exchanges. The certification requirements mandated by SEBI or by the exchanges make the members eligible for continued admittance norm for membership of the Exchange. Further, member should satisfy the minimum net worth and deposit requirement as specified by SEBI/Exchanges/Clearing Corporation from time to time.

The Exchange may also specify such standards for investor service and infrastructure with regards to any category of applicants as it may deem necessary, from time to time.

In addition to SEBI Stock Broker regulation 2026, for additional information participants are requested to refer Section 8: "Qualifications for membership of a recognised stock exchange" of Securities Contract (Regulation) Rules, 1957.

**Fit and Proper Person[21]**

For the purpose of determining whether an applicant or the stock broker, Authorized Persons trading member and clearing member is a fit and proper person, the SEBI Board may take into account of any consideration as it deems fit including but not limited to the following criteria in relation to the applicant or the intermediary, the principal officer [the director, the promoter] and the key management persons by whatever name called:
(a) Integrity, reputation and character
(b) Absence of convictions and restraints order

[21] Schedule II, SEBI (Intermediaries) Regulations, 2008.

(c) Competence including financial solvency and net worth of the applicant
(d) Absence of categorisation as a wilful defaulter.

**Authorized Person:**

Authorized person is not a member of a Stock Exchange but is 'Any person, individual, partnership firm, LLP or body corporate, who is appointed as such by a Stock Broker (including Trading Member) and who provides access to trading platform of a Stock Exchange as an agent of the Stock Broker'. Trading members are entitled to appoint authorized person to operate the trading workstations of various segment, with the approval of the exchange. The trading member has to obtain specific prior approval for each such person, and it is segment specific. Authorized Person (AP) should satisfy the criteria as specified by SEBI/stock exchanges from time to time. The AP should have the necessary infrastructure like adequate office space, equipment and manpower to effectively discharge the activities on behalf of the stock broker. The Trading Member and Authorised Person shall enter into written agreement(s) in the form(s) prescribed by the Exchange. The agreement shall inter-alia cover scope of the activities, responsibilities, confidentiality of information, commission sharing, termination clause etc. The Trading Member shall be responsible for all acts of omission and commission of the Authorised Person as it shall be deemed to be that of the Trading Member.

#### 2.4.2.2 Custodian

Custodian means any person who carries on or propose to carry on the business of providing custodial service. To provide custodian services entity has registered with SEBI and obtain certificate to carry custodian services. A Custodian is an entity that is responsible for safeguarding the securities of its clients. Besides safeguarding securities, a custodian also keeps track of corporate actions on behalf of its clients. It also helps in:

- Maintaining a client's securities account
- Collecting the benefits or rights accruing to the client in respect of securities
- Keeping the client informed of the actions taken or to be taken by the issuer of securities, having a bearing on the benefits or rights accruing to the client.
- Maintaining and reconciling records of the above services

Custodians are clearing members but not trading members. They settle trades on behalf of the clients of the trading members, when a particular trade is assigned to them for settlement. The custodian is required to confirm whether he is going to settle that trade or not. In case the custodian fails to confirm then the onus of settling the trade falls on the trading member or clearing member of the trading member who has executed the trade.

## 2.5 Regulators

The regulators in the Indian securities market ensures that the market participants behave in a desired manner so that securities market continue to be a major trusted source of

finance for corporate and Government and the interest of investors are protected. The different regulators who regulate the activities of the different sectors in the financial market are as given below:

- SEBI regulates the securities market and the commodity derivatives market.
- Reserve Bank of India (RBI) is the authority to regulate and monitor the banking sector.
- Insurance Regulatory and Development Authority of India (IRDAI) regulates the insurance sector.
- Pension Fund Regulatory and Development Authority (PFRDA) regulate the pension fund sector.
- International Financial Services Centres Authority (IFSCA) is a unified authority for the development and regulation of financial products, financial services and financial institutions in the IFSC in India.
- Ministry of Finance (MOF)
- Ministry of Corporate Affairs (MCA)

We would be discussing about the role of SEBI as it is the regulatory authority for the securities market in India.

Most of the powers under the SCRA are exercisable by the Department of Economic Affairs (DEA) of Ministry of Finance while a few others by SEBI. The powers of the DEA under the SCRA are also concurrently exercised by SEBI.

The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are primarily administered by SEBI. The rules under the securities laws are framed by Government and regulations by SEBI. All these are administered by SEBI. The powers under the Companies Act relating to the issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies and public companies proposing to get their securities listed. The Self-Regulatory Organizations (SROs) ensure compliance with their own rules as well as with the rules relevant for them under the securities laws.

### 2.5.1 Role of Securities Exchange Board of India (SEBI)

The Securities and Exchange Board of India (SEBI) is the regulatory authority in India established under Section 3 of SEBI Act, 1992 under an Act of Parliament. SEBI's primary role is to protect the interest of the investors in securities and to promote the development of securities market and regulate the securities market, by measures it thinks fit.

**Role of SEBI:**

- Protecting the interests of investors in securities.
- Promoting the development of the securities market.
- Regulating the business in stock exchanges and any other securities markets.
- Registering and regulating the working of stock brokers, Authorized Persons etc.
- Promoting and regulating self-regulatory organizations
- Prohibiting fraudulent and unfair trade practices
- Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, intermediaries, self-regulatory organizations, mutual funds and other persons associated with the securities market.

### 2.5.2 Regulatory Framework for Securities Market

The process of liberalization of the Indian securities market started in 1992. The aim was to liberalize the securities market, ensure protection of the interests of the investor, to have a regulated market and to develop the securities market. Various Acts were promulgated, and legislations amended towards this goal. The four main Acts governing the securities market are:

- The SEBI Act, 1992
- The Securities Contract (Regulation) Act {SC(R)A}, 1956
- The Depositories Act, 1996
- The Companies Act, 2013.

Apart from the four Acts, from time to time SEBI issues rules, regulations, guidelines, circulars etc. The details of the same is available on SEBI website. Given below details of few Regulations/Acts which are also of high importance in the regulation of Indian Securities Markets:

- The Securities Contracts (Regulations) Rules, 1957
- Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018
- SEBI (Stock Brokers) Regulations, 2026
- SEBI (Prevention of Insider Trading) Regulations, 2015
- Prevention of Money laundering Act, 2002
- SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations 2003
- SEBI (Custodians) Regulations, 1996
- SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011
- SEBI {KYC (Know Your Client) Registration Agency} Regulations, 2011

- SEBI (Intermediaries) Regulations, 2008
- SEBI (Depositories & Participants) Regulations, 2018.

***SEBI Act, 1992***

The SEBI Act, 1992 was enacted to empower SEBI with statutory powers for
(a) Protecting the interests of investors in securities,
(b) Promoting the development of the securities market, and
(c) Regulating the securities market.

Its regulatory jurisdiction extends over corporates (who list or propose to list their securities) in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities (more specifically the capital market) market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and to penalize them in case of violations of the provisions of the Act, Rules and Regulations made thereunder. SEBI has full autonomy and authority to regulate and develop an orderly securities market. The orders of SEBI under the securities laws are appealable before a Securities Appellate Tribunal (SAT).

***Securities Contracts (Regulation) Act, 1956***

It provides for direct and indirect control of virtually all aspects of securities trading and the running of Stock Exchanges and aims to preventing undesirable transactions in securities.

It gives Central Government the regulatory jurisdiction over-
(a) Stock Exchanges through a process of recognition and continued supervision
(b) Contracts in securities, and
(c) Listing of securities on Stock Exchanges

As a condition of recognition, a Stock Exchange complies with conditions prescribed by Central Government. Organized trading activity in securities takes place on a specified recognized stock Exchange. The Stock Exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules.

***Depositories Act, 1996***

The Depositories Act enables the setting up of multiple depositories in the country. This was to ensure that there is competition in the service and more than one depository in operation. The Depositories Act facilitated the establishment of the two depositories in India viz., NSDL and CDSL.

Only a company registered under the Companies Act, 2013 or (hitherto Companies Act 1956) and sponsored by the specified category of institutions can set up a depository in India. Before commencing operations, depositories should obtain a certificate of registration and a certificate of commencement of business from SEBI. A depository established under the Depositories Act can provide any service connected with recording of allotment of securities or transfer of ownership of securities in the record of a depository. A depository, however, cannot directly open accounts and provide services to clients. Any person willing to avail of the services of the depository can do so by entering into an agreement with the depository through any of its Depository Participants. The rights and obligations of depositories, depository participants, issuers and beneficial owners are indicated clearly in this Act.

***Companies Act, 2013***

The Companies Act, 2013 deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, providing annual reports and other information.

Section 24 of the Companies Act 2013, delegates the power to regulate and transfer securities to SEBI. The provision contained in chapter VI, section 127 and section 24 shall,-

(a) In so far as they relate to – (i) issue and transfer of securities; and (ii) non-payment of dividend; by listed companies or those companies which intend to get their securities listed on any recognized stock exchange in India, except as provided under this Act, be administered by the SEBI by making regulations in this behalf.

(b) in any other case, be administered by the Central Government.

***Securities Contract (Regulation) Rules, 1957***

Central Government has made these rules in exercise of the powers conferred by section 30 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956). The Securities Contract (Regulation) Rules, 1957 (SCRR 1957) provide guidelines on application and recognition of stock exchanges, qualifications for membership on a recognised stock exchange, Books of account and other documents to be maintained and preserved by every recognised stock exchange and stock brokers, requirements with respect to the listing of securities, units or any other instrument of a Collective Investment Scheme on a recognised stock exchange.

***Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018***

The Securities Contract (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (SECC Regulations) were notified on October 03, 2018. These regulations provide for procedural norms on recognition, net worth, ownership and governance for stock exchanges, and clearing corporations. These regulations provide for modalities for monitoring shareholding limits and compliance with 'fit and proper' criteria for all shareholders. SECC Regulations mandates that the compensation policy for key management personnel of stock exchange/ clearing corporation to be in accordance with the norms specified by SEBI. These regulations also enlist the mechanism for listing of stock exchanges. The SECC Regulations mandate segregation of regulatory departments in stock exchange from other departments. These regulations are required to be read in conjunction with the SCRA 1956, SCRR 1957, and other applicable laws.

***SEBI (Stock Broker) Regulation, 2026***

The SEBI (Stock Brokers) Regulation, 2026, has replaced SEBI (Stock Brokers) Regulation 1992. A regulation embodies the regulatory framework for registration of stock brokers and clearing members, specifying their operational and general obligations and responsibilities, and for matters connected therewith or incidental there to. The chapter VIII of the SEBI (Stock Broker) regulation provided code of conduct for stock broker. It states that the stock broker shall --

- "Maintain high standards of integrity, promptitude and fairness in the conduct of all his business.
- Act with due skill, care and diligence in the conduct of all his business.
- Not indulge in manipulative, fraudulent or deceptive transactions or schemes or spread rumors with a view to distorting market equilibrium or making personal gains.
- Not create false market either singly or in concert with others or indulge in any act detrimental to the investors' interest or which leads to interference with the fair and smooth functioning of the market". etc.

In its duty to the investor, the stock broker, in his dealings with the clients and the general investing public shall faithfully execute the orders for buying and selling of securities at the best available market price. The broker, as per the regulation, shall issue without delay to his client a contract note for all transactions in the form specified by the exchanges.

This regulation also prescribes the brokers to maintain the different books of accounts, records and documents. These have been discussed in the chapter 3, under section 3.4.4. Some code of conduct to be adhered to by stock-brokers are given in Annexure 1.

***Prevention of Money Laundering Act, 2002***

In the PMLA, 2002, money laundering has been defined as "any process or activity connected with proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property".

The Prevention of Money-Laundering Act, 2002 (PMLA), is an act to prevent money-laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for related matters.

**Chapter II, section 3** of this act describes the offence of money-laundering thus: whoever directly or indirectly attempts to indulge, or knowingly assists or knowingly is a party or is actually involved, in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of the offence of money-laundering.

(i) a person shall be guilty of offence of money-laundering if such person is found to have directly or indirectly attempted to indulge or knowingly assisted or knowingly is a party or is actually involved in one or more of the following processes or activities connected with proceeds of crime, namely (a) concealment; or (b) possession; or(c) acquisition; or (d) use; or (e) projecting as untainted property; or (f) claiming as untainted property, in any manner whatsoever.

(ii) the process or activity connected with proceeds of crime is a continuing activity and continues till such time a person is directly or indirectly enjoying the proceeds of crime by its concealment or possession or acquisition or use or projecting it as untainted property or claiming it as untainted property in any manner whatsoever.

**Section 4** of the PMLA describe the punishment for money laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment which shall not be less than three years, but which may extend to seven years and shall also be liable to fine. Provided that where the proceeds of crime involved in money-laundering relates to any offence specified under paragraph 2 of Part A of the Schedule, the rigorous imprisonment shall extend to ten years.

**Section 6** of the PMLA confers powers on the Central Government to appoint an Adjudicating Authority to exercise jurisdiction, powers and authority conferred by or under this Act.

According to **Section 9,** in the event of an order of confiscation being made by an Adjudicating Authority (AA) in respect of any property of a person, all the rights and title in such property shall vest absolutely in the Central Government without any encumbrances.

**Section 11** of the Act makes it clear that the Adjudicating Authority shall have the same powers as are vested in a civil court under the Code of Civil Procedure while trying a suit, with regard to the following matters:

a) Discovery and inspection
b) Enforcing the attendance of any person, including any officer of a banking company or a financial institution or a company and examining him on oath
c) Compelling the production of records
d) Receiving evidence on affidavits
e) Issuing commissions for examination of witnesses and documents
f) Any other matter which may be prescribed

All the persons summoned as mentioned above shall be bound to attend the proceedings in person or through authorized agents and shall be bound to state the truth and produce such documents as may be required. Further, every proceeding under the section shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 of the Indian Penal Code (IPC).

**Section 12** of the Act stipulates that every reporting entity (i.e., a banking company, financial institution, intermediary or a person carrying on a designated business or profession) shall-
(a) Maintain a record of all transactions, including information relating to transactions in such manner as to enable it to reconstruct individual transactions. The records shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

(b) Furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed; [22]

(c ) Maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients. The records shall

[22] Director means a Director or Additional Director or Joint Director, as the case may be, appointed under sub-section (1) of section 49 (Appointment and powers of authorities and other officers)

be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

(d) Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force, shall be kept confidential.

The Central Government may, by notification, exempt any reporting entity or class of reporting entities from any obligation.

**Section 12 AA of PMLA** stipulates enhanced due diligence by reporting entities.

1. Every reporting entity shall, prior to the commencement of each specified transaction,

(a) verify the identity of the clients undertaking such specified transaction by authentication under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016) in such manner and subject to such conditions, as may be prescribed, provided that where verification requires authentication of a person who is not entitled to obtain an Aadhaar number under the provisions of the said Act, verification to authenticate the identity of the client undertaking such specified transaction shall be carried out by such other process or mode, as may be prescribed.

(b) take additional steps to examine the ownership and financial position, including sources of funds of the client, in such manner as may be prescribed.

(c) take additional steps as may be prescribed to record the purpose behind conducting the specified transaction and the intended nature of the relationship between the transaction parties.

The information obtained while applying the enhanced due diligence measures shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

(2) Where the client fails to fulfil the above conditions, the reporting entity shall not allow the specified transaction to be carried out. Specified transaction means:

- any withdrawal or deposit in cash, exceeding such amount.
- any transaction in foreign exchange, exceeding such amount.
- any transaction in any high value imports or remittances.
- such other transaction or class of transactions, in the interest of revenue or where there is a high risk of money-laundering or terrorist financing, as may be prescribed.

(3) Where any specified transaction or series of specified transactions undertaken by a client is considered suspicious or likely to involve proceeds of crime, the reporting entity shall

increase the future monitoring of the business relationship with the client, including greater scrutiny or transactions in such manner as may be prescribed.

**Sections 16 and 17** lay down the powers of the authorities to carry out summon, searches and seizures.

**Section 24** makes it clear that in the case of person charges with the offense of money laundering under section 3, the Authority or court shall, unless the contrary is proved, presume that such proceeds of crime are involved in money-laundering. Hence, when a person is accused of having engaged in money-laundering, the burden of proving that the proceeds of the alleged crime are untainted shall be on the accused.

**Sections 25 and 26** relate to the establishment of an Appellate Tribunal and the procedures for filing an appeal to the Appellate Tribunal.

**Section 41 & 42** deals with appeals to high court against any decision or order of the Appellate Tribunal within stipulated time.

**Section 43** empowers the Central Government to designate one or more Courts of Session as Special Courts for the trial of the offence of money-laundering.

***SEBI Guidelines on Anti-Money Laundering***

SEBI has laid down guidelines/master circulars on Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism (CFT) /Obligations of Securities Market Intermediaries under the PMLA 2002 and Rules framed for all the intermediaries registered with SEBI.

The SEBI Directives[23] provide a general background and summary of the main provisions of the applicable anti-money laundering and anti-terrorist financing legislations in India. They also provide guidance on the practical implications of the Prevention of Money Laundering Act,2002 (PMLA). The Directives also set out the steps that a registered intermediary or its representatives shall implement to discourage and to identify any money laundering or terrorist financing activities. These Directives are intended for use primarily by intermediaries registered under Section 12 of the SEBI Act, 1992, Stock Exchanges, Depositories and other recognised entities under the SEBI Act and Regulations and rules thereunder.

[23]https://www.sebi.gov.in/legal/master-circulars/jun-2024/guidelines-on-anti-money-laundering-aml-standards-and-combating-the-financing-of-terrorism-cft-obligations-of-securities-market-intermediaries-under-the-prevention-of-money-laundering-act-2002-a-_83942.html

As per the provisions of PMLA and the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (Maintenance of Records Rules), as amended from time to time and notified by the Government of India, every reporting entity (which includes intermediaries registered under section 12 of the SEBI Act, i.e. a stock-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, asset management company, depository participant, merchant banker, portfolio manager, investment adviser and any other intermediary associated with the securities market and registered under Section 12 of the SEBI Act and stock exchanges), shall have to adhere to the client account opening procedures, maintenance records and reporting of such transactions as prescribed by the PMLA and rules notified there under. The Maintenance of Records Rules empower SEBI to specify the information required to be maintained by the intermediaries and the procedure, manner and form in which it is to be maintained. It also mandates the reporting entities to evolve an internal mechanism having regard to any guidelines issued by the regulator for detecting the transactions specified in the Maintenance of Records Rules and for furnishing information thereof, in such form as may be directed by SEBI.

The directives provided guidance to intermediaries & SEBI regulated entities on Policies and Procedures to Combat Money Laundering and Terrorist Financing, Written Anti Money Laundering Procedures, Client Due Diligence, Policy for acceptance of clients, Client identification procedures, Reliance on third party for carrying out Client Due Diligence (CDD), Risk Management, Monitoring of transactions, Suspicious Transaction Monitoring and Reporting, Procedure for freezing of funds, financial assets or economic resources or related services, Record Management, Reporting to Financial Intelligence Unit-India, Designation of officers for ensuring compliance with provisions of PMLA, Hiring and Training of Employees and Investor Education etc.

All registered intermediaries shall develop client acceptance policies and procedures that aim to identify the types of clients that are likely to pose a higher than average risk of Money Laundering or Terrorist Financing. SEBI master circular has advised member to categorized client as Low Risk, Medium Risk and High Risk based on the due diligence or KYC documents. By classifying the clients under various risk categories, effective monitoring and due diligence can be applied to thwart any illegal/unlawful transactions. The risk category of the client is based on several parameters such as location of client, nature of business activity, volume and value of turnover, nature of transaction, manner of payments, etc. Clients of special category like politically exposed person, clients from high risk countries etc. may, if necessary, be classified with an even higher degree of risk.

SEBI also advise intermediaries to appoint Principal Officer and appointment of Designated Director to ensure compliance with provisions of PMLA

***SEBI (Prohibition of Insider Trading) Regulations, 2015***

Insider Trading essentially denotes dealing in a company's securities on the basis of confidential information relating to the company which is not published or not known to the public (known as unpublished price sensitive information), used to make profits or avoid loss.

Insider Trading is considered as an offence and is hence prohibited as per the SEBI (Prohibition of Insider Trading) Regulations, 2015. These regulations came into force with effect from May 2015.

Any dealing/trading done by an insider based on information which is not available in public domain, gives an undue advantage to insiders and affects market integrity. This is not in line with the principle of fair and equitable markets. Thus, in order to protect integrity of the market, the SEBI (Prohibition of Insider Trading) Regulations have been put in place. The Regulations lay down the definition of 'Insiders'; restrictions on communication and trading by insiders; disclosures of trading by them; and the systemic provisions which need to be laid down and followed by listed company, proposed to be listed company as well as intermediaries.

Regulation 2(g) of the SEBI Insider regulations, defines an 'insider' any person who is:
i) a connected person (regulation 2(d)); or
ii) in possession of or having access to unpublished price sensitive information;

*NOTE: Since "generally available information" is defined, it is intended that anyone in possession of or having access to unpublished price sensitive information should be considered an "insider" regardless of how one came in possession of or had access to such information. Various circumstances of the manner in which one came into possession of or had access to such information. Various circumstances are provided to enable such a person to demonstrate that he has not indulged in insider trading. Therefore, this definition is intended to bring within its reach any person who is in receipt of or has access to unpublished price sensitive information. The onus of showing that a certain person was in possession of or had access to unpublished price sensitive information at the time of trading would, therefore, be on the person leveling the charge after which the person who has traded when in possession of or having access to unpublished price sensitive information may demonstrate that he was not in such possession or that he has not traded*

*or he could not access or that his trading when in possession of such information was squarely covered by the exonerating circumstance.*

As per regulation, "Connected Person" any person who is or has been, during the six months prior to the concerned act, associated with a company, in any capacity, directly or indirectly, including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship, whether temporary or permanent, with the company, that allows such a person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.
The person falling within the following categories shall be deemed to be connected person unless the contrary is established.
1) Relative of connected person as specified above.
2) A holding company or associate company or subsidiary company.
3) An intermediary as specified in Section 12 of SEBI Act or an employee or director thereof.
4) An investment company, trustee company, assets management company, or an employee or director thereof.
5) An official of a stock exchange or a clearinghouse or corporation.
6) A member of the board of trustees of a mutual fund or a member of the board thereof.
7) A member of the board of directors or an employee of a public financial institution as defined in Section 2(72) of the Companies Act, 2013.
8) An official or an employee of a self-regulatory organization recognised or authorised by the SEBI.
9) A banker of the company
10) A concern, firm, Hindu undivided family, company, or an association of persons wherein a director of the company or his immediate relative or banker of the company, has more than ten percent of the holding of interest.
11) a firm or its partner or its employee in which a connected person specified in above clauses is also a partner
12) a person sharing household or residence with a connected person specified in above clauses

Regulation 2(n) defines unpublished price sensitive information as any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:

- financial results;
- dividends;
- change in capital structure;

- mergers, de-mergers, acquisitions, delisting, disposals and expansion of business, award or termination of order/contracts not in the normal course of business and such other transactions;
- changes in key managerial personnel; other than due to superannuation or end of term, and resignation of a Statutory Auditor or Secretarial Auditor;
- change in rating(s), other than ESG rating(s);
- fund raising proposed to be undertaken;
- agreements, by whatever name called, which may impact the management or control of the company;
- initiation of forensic audit, by whatever name called, by the company or any other entity for detecting mis-statement in financials, misappropriation/ siphoning or diversion of funds and receipt of final forensic audit report;
- outcome of any litigation(s) or dispute(s) which may have an impact on the company;
- granting, withdrawal, surrender, cancellation or suspension of key licenses or regulatory approvals

**This list is not exhaustive. Participant may refer SEBI regulation for additional details.**

*NOTE: It is intended that information relating to a company or securities, that is not generally available would be unpublished price sensitive information if it is likely to materially affect the price upon coming into the public domain. The types of matters that would ordinarily give rise to unpublished price sensitive information have been listed above to give illustrative guidance of unpublished price sensitive information.*

Chapter II of regulation describe restriction on communication and trading by Insiders, Chapter II (A) describe restrictions on communication in relation to and trading by insiders in the units of mutual funds and Chapter III specifies disclosure of trading by Insiders.

***SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003***

The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations 2003 enable SEBI to investigate into cases of market manipulation and fraudulent and unfair trade practices.

As per Regulation 2(1) (c) “fraud” includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, and shall also include—

(1) a knowing misrepresentation of the truth or concealment of material fact in order that another person may act to his detriment;

(2) a suggestion as to a fact which is not true by one who does not believe it to be true;
(3) an active concealment of a fact by a person having knowledge or belief of the fact;
(4) a promise made without any intention of performing it;
(5) a representation made in a reckless and careless manner whether it be true or false;
(6) any such act or omission as any other law specifically declares to be fraudulent,
(7) deceptive behavior by a person depriving another of informed consent or full participation,
(8) a false statement made without reasonable ground for believing it to be true.
(9) the act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price.

Section 3 describes prohibition of certain dealing in securities. No person shall directly or indirectly—
(a) buy, sell or otherwise deal in securities in a fraudulent manner;
(b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made there under;
(c) employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;
(d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made there under.

Section 4 describes prohibition of manipulative, fraudulent and unfair trade practices. No person shall indulge in a manipulative, fraudulent or an unfair trade practice in securities markets.[24]
Regulation 4(2) describes instances of what would be deemed as a manipulative, fraudulent or an unfair trade practice and includes the following:

a) Knowingly indulging in an act which creates a false or misleading appearance of trading in the securities market.

[24] (i) any act of diversion, mis-utilisation or siphoning off of assets or earnings of a company whose securities are listed or any concealment of such act or any device, scheme or artifice to manipulate the books of accounts or financial statement of such a company that would directly or indirectly manipulate the price of securities of that company, or(ii) transactions through mule accounts for indulging in manipulative, fraudulent and unfair trade practice shall be and shall always be deemed to have been included in sub-regulation (1).

b) Dealing in a security not intended to effect transfer of beneficial ownership but only to operate as a device to inflate, depress or cause fluctuations in the price of the security for wrongful gain or avoidance of loss.
c) inducing any person to subscribe to an issue of the securities for fraudulently securing the minimum subscription to such issue of securities, by advancing or agreeing to advance any money to any other person or through any other means.
d) inducing any person for dealing in any securities for artificially inflating, depressing, maintaining or causing fluctuation in the price of securities through any means including by paying, offering or agreeing to pay or offer any money or money's worth, directly or indirectly, to any person.
e) Any act or omission amounting to manipulation of the price of a security including influencing or manipulating the reference price or bench mark price of any securities".
f) Knowingly publishing or causing to publish or reporting or causing to report by a person dealing in securities any information relating to securities, including financial results, financial statements, mergers and acquisitions, regulatory approvals, which is not true or which he does not believe to be true prior to or in the course of dealing in securities.
g) Entering into a transaction in securities without intention to perform it or without intention to change the ownership of such securities.
h) Selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities whether in physical or dematerialized form: Provided that if: (i) the person selling, dealing in or pledging stolen, counterfeit or fraudulently issued securities was a holder in due course; or (ii) the stolen, counterfeit or fraudulently issued securities were previously traded on the market through a bonafide transaction, (iii) such selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities shall not be considered as a manipulative, fraudulent, or unfair trade practice.
i) Disseminating information or advice through any media, whether physical or digital, which the disseminator knows to be false or misleading and which is designed or likely to influence the decision of investors dealing in securities.
j) A market participant entering transactions on behalf of client without the knowledge of or instructions from client or mis-utilizing or diverting the funds or securities of the client held in fiduciary capacity.
k) Circular transactions in respect of a security entered into between "persons including intermediaries" to artificially provide a false appearance of trading in such security or to inflate, depress or cause fluctuations in the price of such security.
l) Fraudulent inducement of any person by a market participant to deal in securities with the objective of enhancing his brokerage or commission or income.
m) An intermediary predating or otherwise falsifying records including contract notes, client instructions, balance of securities statement, client account statements.

n) Any order in securities placed by a person, while directly or indirectly in possession of information that is not publicly available, regarding a substantial impending transaction in those securities, its underlying securities or its derivative.
o) Knowingly Planting false or misleading news or information which may induce sale or purchase of securities
p) Mis-selling[25] of securities or services relating to securities market.
q) Illegal mobilization of funds by sponsoring or causing to be sponsored or carrying on or causing to be carried on any collective investment scheme by any person.

We here describe the act of front running as an example of unfair trade practices. 'front running' means usage of non-public information to directly or indirectly, buy or sell securities or enter into options or futures contracts, in advance of a substantial order, on an impending transaction, in the same or related securities or futures or options contracts, in anticipation that when the information becomes public; the price of such securities or contracts may change." Front running can be described as an illegal act on part of a dealer/stock broker in which the broker places his own/firm's order ahead of client's order or when client's order is pending. This act of dealer/broker gives him/her an unfair advantage if price of a security is likely to be affected by client' order. Front running could be in the form of buying/selling ahead of client's purchase or sale order. Such act on part of dealer / broker amounts to violation of Section 12A (a), (b) and (e) of the SEBI Act, 1992 or Regulations 3 (a) to (d) and Regulation 4(q) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003.

When SEBI has reasonable grounds to believe that the transaction in securities is being dealt with in a manner detrimental to the investor or the securities market in violation of these regulations and when any intermediary has violated the rules and regulations under the act then it can order to investigate the affairs of such intermediary or persons associated with the securities market. Based on the report of the investigating officer, SEBI can initiate action for suspension or cancellation of registration of an intermediary. Under the SEBI Act, any person who indulges in fraudulent and unfair trade practices shall be liable with penalty. In addition to this, SEBI has the ability to initiate parallel civil enforcement proceedings on the same set of facts.

[25] Mis-selling" means sale of securities or services relating to securities market by any person, directly or indirectly, by (i) knowingly making a false or misleading statement, or (ii) knowingly concealing or omitting material facts, or (iii) knowingly concealing the associated risk, or (iv) not taking reasonable care to ensure suitability of the securities or service to the buyer.

**Box 2: Illegal Trading in Securities (Dabba Trading) and Consequences thereof [26]**

As per SCRA 1956, trading in the shares of companies between persons other than members of a recognized stock exchange is illegal. Members of stock exchange are required to get certificate of registration as "Stock Broker" from the SEBI for buying, selling or dealing in the securities. However, certain un-registered persons carry out trades in securities outside the stock exchange mechanism which are illegal trades and are referred to as "Dabba Trading".

Dabba trading is carried out by person not registered with SEBI wherein one person or group of persons carry out trading in securities by using price/quotes of securities available from the stock exchange trading platform / internet/tv screen etc. The details of such dealings are noted down in separately maintained book which may be either in physical or electronic form. In order to avoid audit trail, settlement of transaction is largely done by receiving /paying the difference on account of price movements of securities and without receipt/delivery of securities. Payment/receipt of funds in dabba trades is done using cash i.e., without using the banking system.

*Consequences of Illegal Trading (Dabba Trading)*

In such illegal trading, investors are subjected to credit risk as there is a possibility of persons who has carried out illegal (dabba) trading defaulting in making payment to the investors or that person becoming an insolvent/bankrupt. In such situations, the investors would not have access to the official complaints redressal/arbitration mechanism as is available to investors who have dealt through a SEBI registered stock broker of a recognized stock exchange.

These kind of trades are carried out in cash and hence encourages growth of the "Black Money"; Perpetuates parallel economy, money laundering and criminal activities; leads to tax evasion incurring loss to the exchequer; no guarantee for settlement of transactions and circumvents regulatory environment.

Anybody indulging in dabba trading violates the following provisions of SCRA 1956:

- Section 13: Contracts in securities otherwise than between members of a recognised stock exchange in a notified area are prohibited by this section. Application of section 13 to a particular state or area is done by Central Government through notification in the Official Gazette.
- Section 16: All contracts in securities except spot delivery contracts and contracts permissible under SCRA and the rules, bye-laws and regulations of a recognised stock exchange are illegal.
- Section 17: This section prohibits the business of dealing in securities except with a license granted by SEBI.
- Section 18A: It provides that contracts in derivatives shall be legal and valid only if such contract are traded on a recognised stock exchange and settled on the clearing house of the recognised stock exchange in accordance with the rules and bye laws of such stock exchange.

[26] F. No. 7/10/SM/2009: Guidance Note on Illegal Trading in Securities (Dabba Trading), issued by Ministry of Finance, Department of Economic Affairs, Capital Market Division, Secondary Markets.

- Section19: It specifically prohibits organising or assistance in organising or being a member of any stock exchange, other than recognised stock exchange, for the purpose of assisting in, entering into or performing any contract.

*Punishment under securities law:*

In terms of sections 23(1) of SCRA, any entity/person who contravenes sections 13, 16, 17 or 19 of the SCRA shall be prosecuted and on conviction, he shall be punishable with imprisonment for a term which may extend to ten years or with fine up to Rs. 25 crores or with both. As per section 25 of the SCRA, offences punishable under section 23 are cognizable offences within the meaning of Code of Criminal Procedure, 1973 and as such can be investigated by state law enforcement authorities also. Further section 26 of SCRA permits lodging of complaints of violation of the Act by the state authorities.

In addition to being violative of the securities law, illegal trading (dabba trading) also falls within the purview of section 406, 420 and section 130-B of the Indian Penal Code, 1870.

***SEBI (Custodian) Regulation, 1996***

Custodian means any person who carries on or proposes to carry on the business of providing custodial service. A Custodian is an entity that is responsible for safeguarding the securities of its clients. Besides safeguarding securities, a custodian also keeps track of corporate actions on behalf of its clients. It also helps in:

- Maintaining a client's securities account
- Collecting the benefits or rights accruing to the client in respect of securities
- Keeping the client informed of the actions taken or to be taken by the issuer of securities, having a bearing on the benefits or rights accruing to the client.
- Maintaining and reconciling records of the above services.

The SEBI (Custodian) Regulation 1996, states that to provide custodian services entity has to be registered with SEBI and obtain certificate to carry custodian services. For the purpose of grant of a certificate for activities of a custodian of securities, the entity should have a net worth of a minimum Rs.75 crores and fulfill other eligibility criteria. For determining whether custodian is a fit and proper person the SEBI may take into account the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008.

Chapter III of regulation describes general obligation and responsibilities of custodians. Every custodian shall abide by the Code of Conduct as set out in the Third Schedule of this regulation. Every custodian shall have adequate mechanisms for the purposes of reviewing, monitoring and evaluating the custodian's controls, systems, procedures and safeguards. The activities relating to his business as custodian shall be separate and segregated from all other activities. Further, its officers and employees engaged in providing custodial services shall not be engaged in any other activity carried on by him. Custodian of securities shall

enter into an agreement with each client on whose behalf it is acting as custodian of securities and every such agreement shall provide for the circumstances under which the custodian of securities will accept or release securities from the custody account, will accept or release monies from the custody account; time circumstances under which the custodian of securities will receive rights or entitlements on the securities of the client. Every custodian shall open a separate custody account for each client, in the name of the client whose securities are in its custody and the assets of one client shall not be mixed with those of another client.

Every custodian of securities shall have adequate internal controls to prevent any manipulation of records and documents including audits for securities and rights or entitlements arising from the securities held by it on behalf of its client. Every custodian shall have appropriate safekeeping measures to ensure that such securities goods, assets or documents are protected from theft and natural hazards. The custodian shall ensure compliance with the Investor Charter specified by the SEBI from time to time.

**SEBI {KYC (Know Your Client) Registration Agency} Regulations, 2011**

In 2011 SEBI introduced the concept of KYC Registration Agency (KRAs) with a view to eliminate duplication of KYC process to be executed by the investors and have uniform KYC process across SEBI registered intermediaries. The KRAs shall be administered under SEBI KYC Registration Agency (KRA) Regulations, 2011. The regulation provides details about criteria and procedure for registration of KRAs. It also lists down the functions and obligations for the KRAs and Intermediary[27]. All members have to be registered with any one or more KRAs registered by SEBI as per the SEBI KRA Regulations 2011. The details of guideline for intermediaries related to KYC are given below:

- The client shall be allowed to open an account with intermediaries and transact in securities market as soon as the KYC process is completed.
- After doing the initial KYC of the new clients, the intermediary shall forthwith upload the KYC information on the system of the KRA within 3 working days from the date of completion of KYC process.
- In case a client's KYC documents sent by the intermediary to KRA are not complete, the KRA shall inform the same to the intermediary who shall forward the required information / documents promptly to KRA.
- For existing clients, the KYC data shall be uploaded by the intermediary provided they are in conformity with details sought in the uniform KYC format. While uploading

[27] Intermediary means an entity associated with securities market and registered under sub-section (1A), (1B) and (1) of Section 12 of the SEBI Act, 1992; who is required to do KYC of its clients.

these clients' data the intermediary shall ensure that there is no duplication of data in the KRA system.

- The intermediary shall promptly provide KYC related information to KRA, as and when required.
- The intermediaries shall maintain electronic records of KYCs of clients and keeping physical records would not be necessary.
- The intermediary shall have adequate internal controls to ensure the security / authenticity of data uploaded by it.

The detailed guideline for KRAs related to KYC are given below:

- KRA system shall provide KYC information in data and image form to the intermediary.
- KRA shall send a letter to the client within 2 working days of the receipt of the initial/updated KYC documents from intermediary, confirming the details thereof and shall maintain the proof of dispatch.
- KRA(s) shall develop systems, in co-ordination with each other, to prevent duplication of entry of KYC details of a client and to ensure uniformity in formats of uploading / modification / downloading of KYC data by the intermediary.
- KRA shall maintain an audit trail of the upload / modifications / downloads made in the KYC data, by the intermediary in its system.
- KRA shall ensure that a comprehensive audit of its systems, controls, procedures, safeguards and security of information and documents is carried out annually by an independent auditor. The Audit Report along with the steps taken to rectify the deficiencies, if any, shall be placed before its Board of Directors. Thereafter, the KRA shall send the Action Taken Report to SEBI within 3 months.
- KRA systems shall clearly indicate the status of clients falling under PAN exempt categories viz. investors residing in the state of Sikkim, UN entities / multilateral agencies exempt from paying taxes / filing tax returns in India, etc.
- KRAs shall upload the verified/validated KYC information on to the system of Central KYC Record registry (CKYCRR) within 7 days of receiving the same from intermediaries or any other timeline as notified under PML Rules. The KRAs shall integrate their systems with CKYCRR and commence the uploading of KYC records on CKYCRR from August01, 2024.

**SEBI (Intermediaries) Regulations, 2008**

"Intermediary" means a person mentioned in clauses (b) and (ba) of sub-section (2) of section 11 and sub-section (1) and (1A) of section 12 of the SEBI Act, 1992 and includes an asset management company in relation to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, a clearing member of a clearing corporation or clearing house, foreign portfolio investors and a trading member of a

derivative segment or currency derivatives segment of a stock exchange but does not include foreign venture capital investor, mutual fund, collective investment scheme and venture capital fund;

This regulation provides details on Registration of Intermediaries, General obligation of intermediaries including redressal of investor grievance, appointment of compliance officer, investment advice, code of conduct, Inspection and disciplinary proceedings etc.

SEBI has introduced Chapter III B, for "Usage of Artificial Intelligence "which outlines the responsibilities of intermediaries when using Artificial Intelligence (AI).

(i) Any person regulated by the SEBI who utilizes artificial intelligence (AI) and machine learning(ML) tools and techniques, whether developed in-house or procured from third party providers shall be solely responsible for their use, regardless of the scale or scenario of adoption. Specifically, they are responsible for:

a) The privacy, security and integrity of investors and stakeholders data including data held in a fiduciary capacity throughout the processes involved;

b) The output arising from the usage of such tools and techniques upon which the entity relies

c) Full compliance with applicable laws currently in force.

Additionally, the newly introduced chapter III C addresses the "Verification of past risk and return metrics."

**SEBI (Depositories and Participants) Regulations, 2018**

This regulation provide details on registration, ownership and governance of depositories and depositories participants. It provides rights and obligation of depositories and depositories participants, procedure of creating pledge and hypothecation listing of security, surrender of security etc.

**Chapter 2: Sample Questions**

1. "Entering into a transaction in securities without the intention to perform it or without the intention to change the ownership of such securities" is an example of _____.

   (a) Insider Trading

   **(b) Fraudulent and Unfair Trade**

   (c) Money Laundering

2. Following member does not have trading rights?

   **(a) Professional Clearing Member**

   (b) Only Trading Member

   (c) Trading cum Self Clearing Member

   (d) Trading cum Clearing Member

3. Providing financial guarantee for all transactions executed on the Exchange, is known as _____.

   **(a) Novation**

   (b) Insurance

   (c) Indemnification

   (d) Coverage

4. The records under PMLA shall be maintained for a period of ____ years from the date of transaction between a client and the reporting entity.

   **(a) Five**

   (b) Seven

   (c) Three

   (d) Ten

5. The Companies Act delegates the power to regulate and transfer listed securities to _____.

   **(a) SEBI**

   (b) Clearing Corporations

   (c) Depositories

   (d) Stock Exchanges

# CHAPTER 3: INTRODUCTION TO SECURITIES BROKING OPERATIONS

**LEARNING OBJECTIVES**

After studying this chapter, you should know about:

- Concept of securities trade life cycle
- Front Office, Middle Office and Back Office Operations of a stock broking firm
- Information Technology and Business Continuity Plan of a stock broking firm

## 3.1 Introduction to the Securities Trade Life Cycle

In financial market, "trade" means to buy and/or sell securities/financial products. To explain it further, *a trade is the conversion of an order placed on the Exchange into a pay-in and pay-out of funds and securities. Trade ends with the settlement of the order placed*.

Every trade placed on the stock market has a cycle which can be broken down into pre-trade and post-trade events. Trading of securities involves multiple participants like the investors, brokers, Exchanges, Clearing agency/corporation, Clearing banks, Depository Participants, Custodians etc.

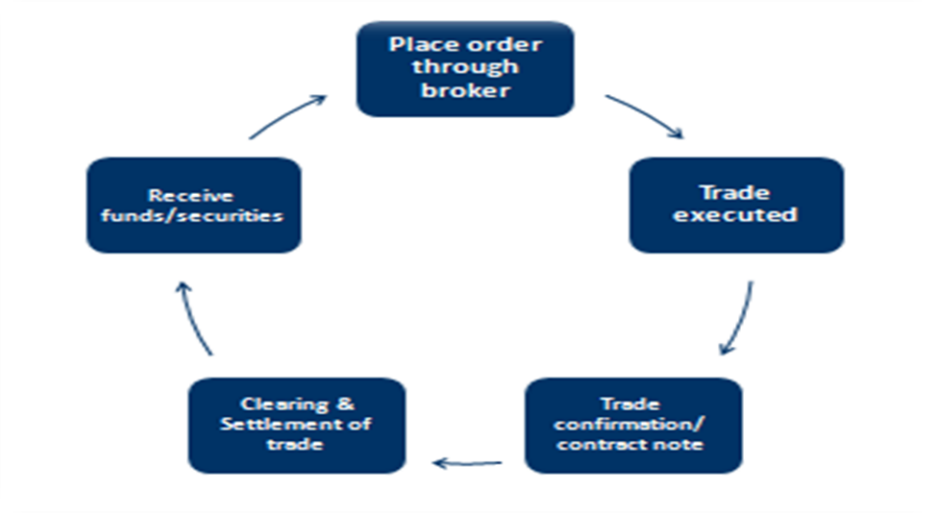
The following steps are involved in a trade's life cycle:

1. Placing of an Order by the investor / client / broker
2. Risk management and routing of order through the trading platform
3. Matching of order and its conversion into trade
4. Confirmation of trades
5. Clearing and Settlement of trades

The above mentioned steps in a trade 's life cycle can easily be categorized into front office, middle office and back office operations of broking firms wherein the placing of an order by the investor / client / broker, matching of order and its conversion into trade and routing of order through the trading platform are generally the front office functions; Risk management is the middle office function; Confirmation of trades and Clearing and Settlement of trades are the back office functions.

In this chapter we discuss these various steps involved in a trade life cycle. Figure 3.1 gives a pictorial representation of the typical trade life cycle for cash/equity/capital segment.

**Figure 3.1: A Typical Securities Trade Life Cycle**




### 3.1.1 Placing of order

#### 3.1.1.1 Trader Workstation

The trader workstation (TWS) is the terminal from which the member accesses the trading system of Exchange. From TWS member entered order into the Exchange trading system. Exchange provides own trading platforms to its member. Each trader has a unique identification by way of Trading Member ID and User ID through which they are able to log on to the system for trading or inquiry purposes.

TWS provides mainly two kinds of information which are:

Trading member's own transaction Information:

- Order entered
- Order Modified
- Outstanding Order
- Order Log
- Trade details

Market Information:

- Order book
- Securities / contract price information
- Securities / contract trade information
- Additional information

Exchanges have allowed members to develop their customized trading workstation as per their requirements and connect to Exchange trading system. Under this facility, the

Exchanges has made available product such as Computer to Computer Link (CTCL) / Internet based trading (IBT) / Direct Market Access (DMA) / Security trading thought wireless technology facility (STWT) / Automated / Algorithm Trading (ALGO) / Smart order router (SOR) to the Trading Members. Trading member can connect to the system by various mode such as lease line, VSAT, co-location[28] etc.

#### 3.1.1.2 Placing of client orders

The Broker accepts orders from the client and sends the same to the Exchange after performing the risk management checks. Clients have the option of placing their orders through various channels like internet, phone, direct market access (DMA) (for institutional clients), Securities trading using wireless technology facility (STWT)/ Automated /Algorithm Trading (ALGO)/ Smart order router (SOR) etc. To strengthen the regulatory provisions against un-authorized trades and to harmonise the requirements across equity & derivative market, all brokers shall execute trades of clients only after keeping evidence of the client placing such order, it could be, inter alia, in the form of: (a) Physical record written & signed by client, (b) Telephone recording, (c) Email from authorized email id, (d) Log for internet transactions, (e) Record of SMS messages, (f) Any other legally verifiable record. When a dispute arises, the broker shall produce the above mentioned records for the disputed trades. However, for exceptional cases such as technical failure etc. where broker fails to produce order placing evidences, the broker shall justify with reasons for the same and depending upon merit of the case, other appropriate evidences like post trade confirmation by client, receipt/payment of funds/ securities by client in respect of disputed trade, etc. shall also be considered. The Brokers are required to maintain the records for a minimum period for which the arbitration accepts investors' complaints as notified from time to time (which is currently three years). However, in cases where dispute has been raised, such records shall be kept till final resolution of the dispute. If SEBI desires that specific records be preserved, then such records shall be kept till further intimation by SEBI.

Placing of orders through the internet/phone means the facility provided by stock brokers, whereby the client can place order(s) over the phone/internet for transactions in securities, to be executed on behalf of clients by the broker.

Here, the dealer shall refer to the Dealing Desk Executive appointed by the call centre(s) for the purpose of providing this facility.

[28] The facility of co-location or proximity hosting (or by whatever name called) is offered by the stock exchanges to stock brokers and data vendors whereby their trading or data-vending systems are allowed to be located within or at close proximity to the premises of the stock exchanges, and are allowed to connect to the trading platform of stock exchanges through direct and private network

- For the purpose of availing of this service, the Client is required to call on the specific numbers intimated or notified from time to time by the stock broker for the said purpose by means of an email and/or by putting up such numbers on the website or otherwise.
- In case the Client opts for this service, he may be required to provide accurate answers to the questions asked by the Dealing Desk Executive, including the Client's user id and TPIN, for ascertaining the genuineness of the caller. Once this is done, the order can be placed and will be processed in the normal course.

SEBI further instructed that wherever the order instructions were received from clients through the telephone, the stock broker shall mandatorily use telephone recording system to record the instructions and maintain telephone recordings as part of its records.[29]

Internet trading can take place through order routing systems, which will route client orders to exchange trading systems for execution. Thus, a client sitting in any part of the country would be able to trade using the Internet as a medium through brokers' Internet trading systems. SEBI-registered brokers can introduce internet based trading after obtaining permission from respective Stock Exchanges. SEBI has stipulated the minimum conditions to be fulfilled by trading members to start internet based trading and services. Broker can provide Securities Trading through Wireless medium on Wireless Application Protocol (WAP) platform. Some additional requirements are to be met by the broker for providing securities transaction through WAP.

Direct Market Access (DMA) is a facility which allows brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker. Some of the advantages offered by DMA are direct control of clients over orders, faster execution of client orders, reduced risk of errors associated with manual order entry, greater transparency, increased liquidity, lower impact costs for large orders, better audit trails and better use of hedging and arbitrage opportunities through the use of decision support tools / algorithms for trading. SEBI in 2008, introduced Direct Market Access (DMA) and permitted institutional investors to use DMA facility. The facility of the DMA provided by the stock broker shall be used by the client or an investment manager of the client. A SEBI registered entity is permitted to act as an investment manager on behalf of institutional clients. In case the facility of DMA is used by the client through an investment manager, the investment manager is required to execute the necessary documents on behalf of the client(s). Exchange can also specify the categories of investors to whom the DMA facility can be extended. SEBI-registered brokers can introduce DMA facility to their clients after obtaining permission from respective Stock Exchanges. Brokers must specifically authorize clients or investment managers acting on

[29] SEBI Circular Ref No.: SEBI/HO/MIRSD/DOP1/CIR/P/2018/54Dated March 22, 2018.

behalf of clients for providing DMA facility, after fulfilling KYC requirements, documentation and carrying out necessary due diligence, records of which should be properly maintained.

Another feature which has been introduced in the Indian securities market is **Algorithmic Trading** and **High Frequency Trading**. Algorithmic Trading – Any order that is generated using automated execution logic shall be known as algorithmic trading[30]. Automated Trading" shall mean and include any software or facility by the use of which, upon the fulfillment of certain specified parameters, without the necessity of manual entry of orders, buy/sell orders are automatically generated and pushed into the trading system of the Exchange for the purpose of matching.

SEBI vide circular dated February 04, 2025, has provided the following key guidelines on "Safer participation of retail investors in Algorithmic trading"[31]. For the purpose of provision of algo trading through Application Programming Interface (APIs), the brokers shall act as the principal while any algo provider or fintech /vendor (hereinafter referred to as "Algo Provider") shall act as the brokers agent, when using the provided API.

- Algos developed by tech-savvy retail investors using their own programming knowledge, must be registered with the Exchange, through their broker, only if they exceed the specified order per second (OPS) threshold.
- Brokers must implement systems and procedures to detect/identify and categorize all orders exceeding the specified threshold as Algo orders.
- Brokers offering Algo trading facilities shall be abide by all the extant SEBI provisions related to algo trading.
- While Algo providers are not directly regulated by SEBI, they must be empaneled with the exchanges in a manner as stipulated by the exchanges to ensure better oversight.,

SEBI has advised the stock exchanges to ensure that all algorithmic orders are necessarily routed through broker servers located in India and the stock exchange has appropriate risk controls mechanism to address the risk emanating from algorithmic orders and trades. The minimum order-level risk controls shall include price check, quantity limit check, order value check etc. Stock exchange shall ensure that the stock broker shall provide the facility of algorithmic trading only upon the prior permission of the stock exchange. SEBI also advised stock exchanges to ensure fair and equitable access to their co-location facility. The stock broker, desirous of placing orders generated using algos, shall satisfy the stock exchange with regard to the implementation of the minimum levels of risk controls at its end as

[30] SEBI Circular Ref. no. CIR/MRD/DP/09/2012 Dated March 30, 2012.
[31]https://www.sebi.gov.in/legal/circulars/feb-2025/safer-participation-of-retail-investors-in-algorithmic-trading_91614.html

specified by SEBI and Exchanges from time to time. The stock brokers that provide the facility of algorithmic trading shall subject their algorithmic trading system to a system audit every six months in order to ensure that the requirements prescribed by SEBI / stock exchanges with regard to algorithmic trading are effectively implemented.[32] Such system audit of algorithmic trading system shall be undertaken by a certified system auditor.

High frequency trading (HFT) is a type of algorithmic trading which is latency sensitive and is characterized by a high daily portfolio turnover and high order-to trade ratio (OTR).

Once the orders are received by the broker, it is confirmed with the client and then entered into the trading system of the Exchange. The Exchange gives confirmation of the order and time stamps it. An order generally comes with certain conditions which determine whether it is a market order, limit order etc. (discussed in section 3.2.2). These specify the terms and conditions at which the client wants his/her order to get executed.

### 3.1.2 Risk Management and Order Routing

An efficient risk management system is integral to an efficient settlement system. The goal of a risk management system is to measure and manage a trading firm's exposure to various risks identified as central to its operations. The implementation of strong and effective risk management and controls within stock brokers promotes stability throughout the entire financial system. Specifically, internal risk management controls provide four important functions:

- to protect the firm against market, credit, liquidity, operational, and legal risks;
- to protect the financial industry from systemic risk;
- to protect the firm's customers from large non-market related losses (e.g., firm failure, misappropriation, fraud, etc.); and
- to protect the firm and its franchise from suffering adversely from reputational risk.

The broker should have online risk management system (including upfront real-time risk management) in place for all orders placed on exchange trading system. The system should have pre-defined limits / checks such as Order Quantity and Value Limits, Symbol wise User Order / Quantity limit, User / Branch Order Limit, Order Price limit, etc. are in place and only such orders which are within the parameters specified by the Risk Management System (RMS) are allowed to be pushed into exchange trading engines. Brokers are required to collect various upfront margin before the execution of trade. Hence, broker RMS has to ensure that order with sufficient margins are allowed to be pushed into the exchange trading engines for matching.

### 3.1.3 Order Matching and Conversion into Trade

[32] SEBI Master Circular dated December 30, 2024, "Master Circular for Stock Exchanges and Clearing Corporations, Chapter 2 - Trading Software and Technology".

All orders which are entered into the trading system of the Exchange are matched with similar counter orders and are executed. The order matching in an Exchange is done on a price time priority basis. The best price orders are matched first. If more than one order is available at the same price, then they are arranged in ascending time order. Best buy price is the highest buy price amongst all orders and the best sell price is the lowest price of all sell orders. This has been discussed in detail in section 3.2.2.3.

Once the order is matched, it results into a trade. As soon as the trade is executed, a trade confirmation message is sent to the broker who had entered the order. The broker in turn lets the client know about the trade confirmation through a contract note and messages. (To understand about a contract note read Box 3.1).

All orders which have not been executed, partly or fully can be modified or cancelled during the trading hours. Trades done during the day can also be cancelled by mutual consent of both the parties subject to approval of the Exchange and as per the trade annulment policy prescribed by SEBI and Exchanges from time to time. These generally occur due to order entry errors and are not a common practice.

### 3.1.4 Affirmation and Confirmation *(For Institutional Clients)*

Institutional clients trading in the Indian securities market use the services of a custodian to assist them in the clearing and settlement of executed trades in cash/equity segment. Custodians are clearing members of the Exchange. On behalf of their clients, they settle the trades that have been executed through brokers. A broker assigns a particular trade to a custodian for settlement by entering custodian participant code at the time of order entry. Upon confirmation by the custodian whether he would settle the trade, the clearing corporations assigns the obligation to the custodian. The overall risk that the custodian is bearing by accepting the trade is constantly measured against the collateral that the institution (who trades) submits to the custodian for providing this service. While confirming the trade Custodian verifies security details, side of the trade, price range etc. as specified by the institutional client.

In 2004, SEBI had mandated that all the institutional trades executed on the Stock Exchanges should be processed through the Straight through Processing (STP) system.[33] STP is a mechanism that automates the end-to-end processing of transactions of the financial instruments. It involves use of a single system to process or control all elements of the work-flow of a financial transaction, including what is commonly known as the Front, Middle, and Back office, and General Ledger. In other words, STP can be defined as electronically capturing and processing transactions in one pass, from the point of first 'deal' to final settlement. STP thus streamlines the process of trade execution and settlement and avoids manual entry and re-entry of the details of the same trade by different market

[33] SEBI Circular Ref. No. DNPD/Cir- 22 /2004 dated April 1, 2004, DNPD/Cir-25/04dated June 10, 2004.

intermediaries and participants. Usage of STP enables orders to be processed, confirmed, settled in a shorter time period and in a more cost effective manner with fewer errors. Apart from compressing the clearing and settlement time, STP also provides a flexible, cost effective infrastructure, which enables e-business expansion through online processing and access to enterprise data.

**Box 3.1: What is a Contract Note?**

Contract note is the legal record of any transaction carried out on a stock exchange through a stockbroker. It serves as the confirmation of trade done on a day on behalf of a client on a stock exchange. Every stock broker shall issue a contract note to its clients for trades executed in such format as specified by the Exchanges. It establishes a legally enforceable relationship between the stock broker and the client in respect of settlement of trades executed on the Exchange as stated in the contract note. Every trade executed by a stock broker on behalf of his client should be supported by a contract note.

Contract note should be issued within 24 hours of execution of contract and in the format prescribed by Exchanges/SEBI. These should be issued in physical form or electronic form depending on the mode chosen by client.

The contract notes should be acknowledged by the clients along with date in case of personal delivery. Stock-brokers are required to maintain proof of dispatch of contract notes in the case of delivery of physical contract notes through post/courier. The digitally signed Electronic Contract Notes (ECNs) may be sent only to those clients who have opted to receive the contract notes in an electronic form, either in the account opening kit or by a separate letter. The usual mode of delivery of ECNs to the clients shall be through e-mail. For this purpose, the client shall provide an appropriate e-mail account to the member which shall be made available at all times for such receipts of ECNs. The acknowledgement of the e-mail shall be retained by the member in a soft and non-tamperable form. The proof of delivery i.e., log report generated by the system at the time of sending the contract notes shall be maintained by the member Stock-Broker should also maintain a bounce mail log showing details of the contract notes that were not delivered to the clients/e mails rejected or bounced back. Whenever ECNs have not been delivered or has bounced, Member should send the physical copy of the contract note to such clients within the stipulated time under the extant regulations of SEBI/stock exchanges and maintain the proof of delivery. All ECNs sent through the e-mail shall be digitally signed, encrypted, non-tamperable and shall comply with the provisions of the IT Act, 2000. In case the ECN is sent through e-mail as an attachment, the attached file shall also be secured with the digital signature, encrypted and non-tamperable. In addition to the e-mail communication of the ECNs in the manner stated above, in order to further strengthen the electronic communication channel, the member shall simultaneously publish the ECN on his designated web-site in a secured way and enable relevant access to the clients. In addition, through e-mail ECN can be send through SMS/electronic instant messaging services only on registered mobile number as uploaded by the member on Exchange portal.

The contract notes should be unique running serially numbered starting from the beginning of the financial year. They should be issued with the client's name, PAN and client's code written on them. It should also contain the exact order number, order entry time, trade number, trade time, quantity of securities transacted, rates/price, etc. Contract notes with weighted average price of trade should contain an annexure with the details thereon.

Stock brokers are required to maintain duplicate copy or counter foil of the contract notes. The contract notes should be signed by stock broker or by an authorized signatory of the stock broker as per the guideline specified by SEBI/Exchanges from time to time. A contract note without consideration is null and void under Indian Contracts Act and hence all contracts should mention the consideration separately. Contract should also mention all statutory charges (like Securities Transaction Tax (STT), Goods and Service Tax (GST), stamp duty etc.), Regulatory levies / charges (e.g., SEBI turnover fees, Exchange transaction charges, etc.), Brokerage etc. Contract notes should be affixed with the brokers note stamps,

as a percentage of the total value of the contract, as per the government stamp acts / rules. Contracts note also should clearly specify the complete address, phone number, e-mail IDs, fax numbers, the name of the compliance officer, his telephone number and e-mail address etc. of the broker along with the PAN.

### 3.1.5 Clearing and Settlement

Once the trade is executed on the Exchange, the details are passed on to the clearing corporation, to initiate the clearing and settlement of those executed trades. Based on the trade details from the Exchange, the Clearing Corporation determines the obligations of the members. In case of cash segment, institutional trades are sent to custodian and in derivatives custodian participant code trade send to clearing member for confirmation. Based on the affirmation, the clearing corporation applies multilateral netting and determines obligations. The settlement process begins as soon as member's obligations are determined through the clearing process.

The settlement process is carried out by the clearing corporation with the help of clearing banks and the depositories. The clearing corporation provides a major link between the clearing banks and the depositories. This link ensures actual movement of funds as well as securities on the prescribed pay-in and pay-out day.

Instructions are given to the depositories and the clearing banks for pay-in of securities and funds and pay-out of securities and funds. The clearing members have to ensure that they make available the securities / funds to the clearing corporation before pay-in time on settlement day. Once the pay-in activities are carried out, the clearing corporation carries out the pay-out of funds and securities.

SEBI vide Circular No. SEBI/HO/MRD/MRD-PoD-3/P/CIR/2024/20 dated March 21, 2024 introduced the T+0 rolling settlement cycle on optional basis in addition to the existing T+1 settlement cycle in Equity Cash Markets

## 3.2 Front Office Operations

Stock brokers play a crucial intermediary role in facilitating securities transactions between investors and the stock exchanges. Their operations are broadly segmented into three primary stages: Front Office, Middle Office, and Back Office.

The front office is responsible for order capture and execution. This is where the order/trade originates, and the client relationship is maintained. The front office makes/takes orders and executes them. Dealers and sales staff are considered front office staff.

To better understand the subsequent sections, we need to keep in mind the trade life cycle (figure 3.1) discussed earlier. It can be clearly seen from the Figure 3.1 that the main task of the front office staff is to generate orders and execute them. The dealers are the face of the brokers, who communicate with the clients and accept orders. Discussed below are the various front-office related activities.

### 3.2.1 Client On-Boarding and Registration

An important part of a broker's job is finding clients and building a customer base. Thus, securities sales agents spend time in networking and bringing on-board clients.

#### 3.2.1.1 Sales

Traders buy and sell financial products with the goal of making an incremental amount of money on each trade. The sales force, whose primary job is to call on clients to suggest trading ideas and take orders and then communicate their clients' orders to the appropriate trading desks and execute trades. The job of the sales team also includes getting new clients to the brokerage firm. Stock brokers are not allowed to issue advertisements for their business, including on their websites, or through subsidiaries and group companies etc., in contravention to the Code of Conduct specified under Stock Brokers Regulations 2026 and Bye Laws of the concerned Stock Exchange. Members must obtain prior approval for all advertisement from the Exchange before issuance and comply with the Code for Advertisements as prescribed by the Exchange from time to time.

#### 3.2.1.2 Trading Account Opening

This refers only to the trading opening of accounts for new clients. There are certain procedures to be followed before the account can be opened and the broker can execute the orders of the client. With a view to simplify the account opening kit, SEBI has decided that stock broker/depository participant shall make available standard documents to the clients either in electronic or physical form, depending upon the preference of the client as a part of the account opening kit. The preference of the client shall be sought as a part of the account opening form. In case the documents are made available in electronic form, the logs of the same shall be maintained by the broker/depository participant.[34] Client account opening form shall have two parts:

- Know Your Client (KYC) form capturing the basic information about the client and instruction/check list to fill up the form: The KYC template finalised by Central Registry of Securitization and Asset Reconstruction and Security interest of India (CERSAI) and as specified by SEBI through various circulars issued from time to time, shall be used by the registered intermediaries as Part I of Account Opening Form (AOF) for individuals and legal entities.
- Document capturing additional information about the client related to trading account such as bank details, demat details, trading preference[35], past actions, nomination details etc.

The standard documents which form a part of the account opening kit are:

[34] Vide SEBI Circular no. CIR/MIRSD/64/2016 dated July 12, 2016
[35] SEBI circular: SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2023/95 dated June21, 2023

1) **Client Account Opening Form** which is in two parts. a) Know Your Client (KYC) form capturing the basic information about the client and instruction/check list to fill up the form and b) Additional Document capturing additional information about the client related to trading account.
2) Document stating the **Rights & Obligations of stock broker** and client for trading on Exchanges (including additional rights & obligations in case of internet/wireless technology based trading).
3) Uniform **Risk Disclosure Documents (RDD)** for all segments/Exchanges detailing risk associated with dealing in the securities market.
4) **Guidance Note detailing Do's and Don'ts** for trading on Exchanges for the education of the investor.
5) Document describing the **Policies and Procedures** of the stock broker
6) A **tariff sheet** specifying various charges, including brokerage, payable by the client to avoid any disputes at a later date.

In addition to the above documents, the clients should also be provided with the contact details of senior officials (compliance officer in particular) within the stock broking firm and investor grievance cell in the stock Exchange, so that the client can approach them in case of any grievance. It may be noted that any voluntary clause / document added by the stock brokers shall form part of the non-mandatory documents. The stock broker shall ensure that any voluntary clause/document shall neither dilute the responsibility of the stock broker nor it shall be in conflict with any of the clauses in the mandatory documents, Rules, Bye-laws, Regulations, Notices, Guidelines and Circulars issued by SEBI and the Stock Exchanges from time to time. Any such clause introduced in the existing as well as new documents shall stand null and void.

With a view to encourage participation of new individual investors in the securities market, SEBI has prescribed a new simplified Account Opening Form ('AOF') termed as 'SARAL AOF' for new individual investors participating in the cash segment of the Exchange but not availing facilities such as internet trading, margin trading, derivative trading and use of power of attorney. The investors who open account through SARAL AOF will also have the option to obtain other facilities, whenever they require, on furnishing of additional information as per prescribed regulations/circulars. The standard set of documents viz. Rights and Obligations document, Uniform Risk Disclosure Document and Guidance Note and documentary proof related to identity and address as specified by SEBI shall continue to remain applicable. In such case Individual client may submit only one documentary proof of address (either residence/correspondence or permanent) while opening a trading account and / or demat account. It is further clarified that the provisions laid down under the PML Act, PML Rules, SEBI Master Circular on AML is applicable to these set of investors.

SEBI's Master Circular for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors dated May 30, 2024, inter-alia mandates every FPI applicant to submit a duly filled and signed Common Application Form (CAF) and 'Annexure to CAF' supported by required documents for registration. Further, with an objective to facilitate ease of onboarding for FPI applicants and reduce duplication of available information SEBI vide circular dated November 12, 2024, simplified registration for Foreign Portfolio Investors (FPIs).

Details of certain documents to be submitted by the client are enumerated in the following section.

***KYC and Other Documents***

KYC is an acronym for "Know your Client", a term commonly used for Customer Identification Process. SEBI registered intermediaries shall perform KYC in the securities market either through physical mode or digital (online or app based) modes. To ensure uniformity across the securities market, all SEBI registered intermediaries shall use the same KYC form and supporting documentations. SEBI has prescribed certain requirements relating to KYC norms for Financial Institutions and Financial Intermediaries including Mutual Funds and Stock Brokers to 'know' their clients. This entails verification of identity and address, financial status, occupation and such other personal information as may be prescribed by guidelines, rules and regulation.

Know Your Customer (KYC) and Customer Due Diligence (CDD) policies as part of KYC are the foundation of an effective Anti-Money Laundering process. The KYC process requires every SEBI registered intermediary to collect and verify the Proof of Identity (PoI) and Proof of Address (PoA) from the investor. The provisions as laid down under the Prevention of Money-Laundering Act, 2002, Prevention of Money-Laundering (Maintenance of Records) Rules, 2005, as amended from time to time, SEBI Master Circular on Anti Money Laundering (AML) dated June 06, 2024, and relevant KYC / AML circulars issued from time to time shall continue to remain applicable.

**Digital KYC**

To streamline account openings, SEBI permits registered intermediaries to conduct Digital KYC through online or app-based platforms. This process involves capturing a client's PAN, name, photograph, and contact details digitally, supported by electronic signatures like Aadhaar e-Sign. Intermediaries must obtain express client consent before initiating the process.

Verification is conducted using UIDAI's authentication services, including e-KYC or offline methods like QR codes and XML files. Other officially valid documents must be submitted via DigiLocker or digitally signed. To ensure security, mobile numbers and email addresses are verified through OTPs or similar mechanisms.

Stockbrokers favor Aadhaar-based e-KYC for its efficiency and speed in client onboarding. Under Ministry of Finance guidelines, notified securities market entities can act as KYC User Agencies (KUAs) or Sub-KUAs. To utilize these authentication services, brokers must register with UIDAI and enter into formal agreements with a KUA, ensuring a standardized and secure digital verification framework.

The Hon'ble Supreme Court in its judgement dated April 30, 2025, emphasized the need for equal and accessible inclusion of persons with disabilities for availing financial services and directed to ensure that the process of digital KYC is accessible to persons with disabilities.[36] Intermediaries shall extend their services to ensure digital accessibility for all clients including persons with disabilities, and shall be guided by the relevant FAQs on Account opening for such individuals. SEBI has issued guidelines on "Rights of Persons with Disabilities Act, 2016 and rules made thereunder-mandatory compliance by all Regulated Entities"(REs)[37]. SEBI mandates all Digital Platforms of REs must be compliant with the provisions of the Rights of Persons with Disabilities Act, 2016 ("RPwD Act, 2016") and the corresponding rules as specified in the circular

**Requirement of In-Person Verification (IPV)**

It shall be mandatory for all the registered stock brokers to carry out IPV of their clients. The brokers shall ensure that the details like name of the person doing IPV, his designation, organization with his signatures and date are recorded on the KYC form at the time of IPV. The IPV carried out by one SEBI registered intermediary can be relied upon by another intermediary. In case of Stock brokers, their Authorised Persons (appointed by the stock brokers after getting approval from the concerned Stock Exchanges) shall also perform the IPV.

To enable ease of completing IPV of an investor, SEBI has allowed stock brokers Video in Person Verification (VIPV) of an individual investor through their App. The following process shall be adopted in this regard:

[36] https://www.sebi.gov.in/sebi_data/faqfiles/may-2025/1747995205392.pdf
SEBI Circular No.: SEBI/HO/MIRSD/SECFATF/P/CIR/2025/74 dated May 23,2025

[37] https://www.sebi.gov.in/legal/circulars/jul-2025/rights-of-persons-with-disabilities-act-2016-and-rules-made-thereunder-mandatory-compliance-by-all-regulated-entities_95745.html, https://www.sebi.gov.in/legal/circulars/sep-2025/compliance-guidelines-for-digital-accessibility-circular-rights-of-persons-with-disabilities-act-2016-and-rules-made-thereunder-mandatory-compliance-by-all-regulated-entities-dated-july-31-2025-_96862.html

a) Intermediary through their authorised official, specifically trained for this purpose, may undertake live VIPV of an individual client, after obtaining his/her informed consent. The activity log along with the credentials of the person performing the VIPV shall be stored for easy retrieval.
b) The VIPV shall be in a live environment.
c) The VIPV shall be clear and still, the client in the video shall be easily recognisable and shall not be covering their face in any manner.
d) The VIPV process shall include random question and response from the investor including displaying the officially valid document, KYC form and signature or could also be confirmed by an OTP.
e) The intermediary shall ensure that photograph of the client downloaded through the Aadhaar authentication / verification process matches with the investor in the VIPV.
f) The VIPV shall be digitally saved in a safe, secure and tamper-proof, easily retrievable manner and shall bear date and time stamping.

**IPV shall not be required in such cases where:**

a) The KYC of the client has been completed using the Aadhaar authentication/ verification of UIDAI.
b) The KYC form has been submitted online, documents have been provided through Digilocker or any other source which could be verified online.
The broker must ensure that the clients fill-up the KYC form and submit it to them. There are separate forms for individuals and non-individuals. Brokers must also ensure that the following documents are submitted along with the KYC forms by the clients.

- **PAN Card**: PAN is the sole identification number for all participants transacting in securities market, irrespective of the amount of transactions. The stock broker shall verify the PAN of their clients online at the Income Tax website without insisting on the original or copy of PAN card. Under the provisions of the Income-tax Act, 1961 , a PAN allotted to a person shall become inoperative if it is not linked with Aadhaar. Since the PAN is the key identification number and a core part of KYC requirements for all securities market transactions , all registered intermediaries shall ensure a valid PAN in the KYC documentation for all clients. Status of Aadhaar and PAN linkage shall be flagged in the system of KRA. The following are exempted from mandatory requirement of PAN.
    - In case of transactions undertaken on behalf of Central Government and / or State Government and by Officials appointed by Courts e.g., Official Liquidator, Court receiver etc. (under the category of Government) for transacting in the securities market.
    - Investors residing in the state of Sikkim.

- UN entities / multilateral agencies exempt from paying taxes / filing tax returns in India.
- In case of institutional clients, namely, FPIs, MFs, VCFs, FVCIs, Scheduled Commercial Banks, Multilateral and Bilateral Development Financial Institutions, State Industrial Development Corporations, Insurance Companies registered with IRDAI and Public Financial Institutions as defined under the Companies Act, 2013, Custodians shall verify the PAN card details with the original PAN card and provide duly certified copies of such verified PAN details to the intermediary.
- It has further been specified by SEBI, that the E-PAN issued by CBDT can also be produced by FPI for KYC compliance.

- **Proof of Address Document**: List of documents admissible for Proof of Address amongst other include Passport, Aadhaar, Voters identity card, Driving License etc. For detail list participants are requested to refer SEBI / SE guidelines provided from time to time.

  If the correspondence and permanent addresses are different, then proof for both shall be submitted. A client can be authorized to capture the address of a third party as a correspondence address, provided that all prescribed 'Know Your Client' norms are also fulfilled for the third party. The intermediary shall obtain proof of identity and proof of address for the third party. The intermediary shall also ensure that client due diligence norms as specified in Rule 9 of the PML Rules are complied with in respect of the third party.

- **Proof of Identity**: Stock brokers at the time of commencement of an account-based relationship shall identify their clients, verify their identity and obtain information on the purpose and intended nature of the business relationship. The name as mentioned in the KYC form shall match the name as mentioned in the Proof of Identity (PoI) submitted. The list of documents admissible for Proof of Identity amongst other include, the Passport, Aadhaar, Voter identity card, Driving License etc. For detailed list participants are requested to refer to the SEBI / Stock Exchanges guidelines as specified by SEBI/Exchanges from time to time.

- **Identification of Beneficial Ownership**

  SEBI Master Circular SEBI/HO/MIRSD/MIRSDSECFATF/P/CIR/2024/78 dated June 06, 2024 on "Guidelines on Anti-Money Laundering …." has prescribed the approach to be followed towards identification of beneficial ownership. Accordingly, the stock brokers shall be guided by the provisions of the said Master Circular and amendments thereto for the purpose of identification of beneficial ownership of the client. Whenever it is apparent that the securities acquired or maintained through an account are beneficially owned by a party other than the client, that party shall be identified

using client identification and verification procedures. The stock broker shall periodically update all documents, data or information of all clients and beneficial owners collected under the Client Due Diligence (CDD) process.

In case of non-individuals (such as corporates, Partnership firm, trust, HUF, Bank etc.) additional documents (certified copies of equivalent e-documents) to be obtained[38].

- **Requirement of Mobile Number and Email ID**: Registered intermediaries shall upload the mobile number and email address of each client to the KRA system. It shall be ensured that the mobile numbers or email addresses of employees/authorized persons, or distributors are not uploaded on behalf of clients.

- **Bank account details:** The client must also have a valid bank account from which transactions can be made for pay-in/pay-out of funds. The details are to be given with the KYC. A cancelled cheque leaflet with a copy of the bank account statement/ pass book should also be submitted at the time of opening the trading account. This bank account will be mapped to the client's trading account and thereafter, generally, payment will be accepted only from this account. A client can map more than one bank account also but should provide the proof of the same.

- **Demat Details**: The client must have also opened a demat account with a DP for pay-in or pay-out of securities. A copy of the client master given by the respective DP to the client should be submitted to broker at the time of opening the trading A/C.

  Normally the client prefers to open both trading and demat account with the same broker. In that case the client generally give Demat Debit and pledge Instruction (DDPI) / Power of Attorney (POA) in favour of broker for smooth functioning. SEBI has stipulated certain formats and guidelines with respect to DDPI / POA to be followed by the broker.

- **Authority Letter to settle an account:** The settlement of funds shall be done within 24 hours of the payout, unless specifically authorized by client to maintain running account. However, the client can authorize the Broker to retain funds in his Trading Account and maintain it as Running Account. This is called Running Account Authorization. To facilitate this SEBI has approved brokers to collect running authority letter from the client. Authorization shall be signed by the client only & not by any POA holder. In spite of this letter, actual settlement of funds shall be done by the broker, at least once in a calendar quarter or month depending on preference of the client.

- **Rights and Obligations:** The document provides the rights and obligations of the stock broker, authorized persons and client for trading on exchanges. It provides information

[38] SEBI Circular No.CIR/MIRSD/16/2011 dated August 22, 2011 and No.MIRSD/SE/Cir-21/2011 dated October 05, 2011

about client, brokerage charges, margins, transaction & settlement, liquidation/close out, dispute resolution and termination of relationship. It also includes additional rights & obligations in case of internet / wireless technology based trading by the client.

- **Risk Disclosure Document:** This document contains important information on risks involved during trading in Equities/Derivatives Segments of the stock exchanges. All clients are required to read this document and understand the nature of the relationship into which they are entering and the extent of their exposure to risk before trading in Equities/Derivatives Segments of the Exchanges. The documents make the clients aware of various risks such as risk of higher volatility, risk of lower liquidity, risk of rumors, risk of news announcements, system risks and risks involved on holding or writing options. The documents also require members to inform the client any additional provisions defining the features, risks, responsibilities, obligations and liabilities associated with securities trading through wireless technology/ smart order routing or any other technology.
- **Nomination of Eligible Trading Accounts:** Submission of "choice of nomination" for trading accounts has been made voluntary by SEBI vide circular dated September 26, 2023. Investors opening new trading account(s) shall have the choice of providing nomination or opting out nomination. Trading Members shall activate new trading accounts only upon receipt of nomination in the formats specified by SEBI.
- The stock broker shall have documentary evidence of financial details provided by the clients who opt to deal in the derivative segment. In respect of other clients, the stock broker shall obtain the documents in accordance with its risk management system.

  List of Illustrative documents
    - Copy of ITR Acknowledgement
    - Copy of Annual Accounts
    - In case of salary income - Salary Slip, Copy of Form 16
    - Net-worth certificate
    - Bank account statement for last 6 months
    - Copy of Holding statement of de-mat account
    - Any other relevant documents substantiating ownership of assets
    - Self-declaration along with relevant supporting

**Confidentiality of Client Information**

Stock brokers shall keep confidentiality of every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force.

### 3.2.1.3 KRA Agency (Know Your Client Registration Agency)

SEBI has simplified the account opening process for investors and made it uniform across intermediaries in the securities markets as already mentioned above. Further, to avoid duplication of the KYC process with every intermediary, in the year 2011 SEBI has devised the KRA system for centralization of the KYC records in the securities markets.

The clients can open an account with intermediaries and transact in securities market as soon as the KYC process is completed. However, clients whose KYC attributes cannot be verified by KRAs will not be allowed to transact further in the securities market until the attributes are verified. KRAs facilitate the clients to check their KYC status on the KRA website. The different KYC status and implications thereto are also available on the KRAs website.

SEBI has advised all registered KRAs to

a) disseminate the Investor Charter on their websites / through e-mail;

b) display the Investor charter at prominent places in offices etc. to bring to the notice of existing and new investors.[39]

### 3.2.1.4 Central Know Your Client (CKYC) Record Registry (CKYCR)

Government of India has authorized the Central Registry of Securitization and Asset Reconstruction and Security interest of India (CERSAI), set up under sub-section (1) of Section 20 of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, to act as, and to perform the functions of, the Central KYC Records Registry under the PML Rules 2005, including receiving, storing, safeguarding and retrieving the KYC records in digital form of a "client", as defined in clause (ha) sub-section (1) of Section 2 of the Prevention of Money Laundering Act, 2002. As per the 2015 amendment to PML (Maintenance of Records) Rules, 2005 (the rules), every reporting entity shall capture the KYC information for sharing with the Central KYC Records Registry in the manner mentioned in the Rules, as per the KYC template for "individuals" finalised by CERSAI. CKYC refers to Central KYC (Know Your Customer), an initiative of the Government of India which aims to have a system which allows investors to complete their KYC only once before interacting with various entities across the financial sector. CKYC is managed by CERSAI (Central Registry of Securitization Asset Reconstruction and Security Interest of India), which is authorized by Government of India to function as the Central KYC Registry (CKYCR). Thus, CKYCR will act as centralized repository of KYC records of investors in the financial sector with uniform KYC norms and inter-usability of the KYC records across the sector.

[39] Detailed guidelines for intermediaries related to KRA and guideline for KRAs related to KYC of client is given in Chapter 2, under "SEBI {KYC (Know Your Client) Registration Agency} Regulations, 2011".

Stock brokers shall within 10 days after the commencement of an account-based relationship with a client, file the electronic copy of the client's KYC records with the CKYCR. They ensure that all existing KYC records of legal entities and of individual clients are uploaded on to CKYCR when the updated information is obtained/received from the client. Once the KYC form is submitted, a unique KYC Identification Number (also known as CKYC Number) is generated and communicated to the client by SMS / Email.

For additional information on KYC, participant can refer SEBI "Master Circular on Know Your Client (KYC) norms for the securities market" dated October 12, 2023[40] and FAQ on "KYC norms for Securities Market"[41]

### 3.2.1.5 Unique Client Code (UCC)

In 2001, SEBI made it mandatory for brokers to use unique client codes for all clients.[42] Once the formalities of KYC and other details thereon are complete, each client is assigned a unique client code (UCC) by the broker. This acts as an identity for the client with respect to the broker. SEBI has made it mandatory for all the brokers to use unique client codes for all clients while entering orders on their behalf. It is also mandated by SEBI, that the unique client code should be mapped with the PAN number of the client.

The broker has to provide the Stock Exchange(s) with the UCC and the PAN details of the client(s) before entering into any trade for the client. The Stock Exchanges provide an upload facility to the brokers through which the UCC and other client details are uploaded on the stock exchange platform on a regular basis. Stock Exchanges validate UCC and PAN for all orders in all markets (PRO and CLI) at the time of order entry with the details uploaded by members on Exchange. UCC allotted by the trading member (TM) to the client shall be mapped with the demat account of the client. For mapping Stock Exchanges shall share the UCC data with the Depositories which shall include the PAN, segment, TM/CM code and UCC allotted.

SEBI has advised Stock Exchanges to provide a platform to stock brokers to upload the details of their clients, preferably, in sync with the UCC updation module. Stock Brokers shall upload the details of clients, such as, name, mobile number, address for correspondence and E-mail address. Stock Exchanges shall send details of the transactions to the investors, by the end of trading day, through SMS and E-mail alerts uploaded by the stock-brokers. Stock Brokers shall ensure that the mobile numbers/E-mail addresses of their employees /remisiers/authorized persons are not uploaded on behalf of clients. Stock

[40] https://www.sebi.gov.in/legal/master-circulars/oct-2023/master-circular-on-know-your-client-kyc-norms-for-the-securities-market_77945.html
[41] https://www.sebi.gov.in/sebi_data/faqfiles/may-2024/1715694256793.pdf
[42] SEBI Circular no: SMDRP/Policy/CIR-39/2001 dated July 18, 2001 and Circular SEBI/MRD/SE/CIR-34/2003/29/09 dated September 29, 2003

Brokers shall ensure that separate mobile number/E-mail address is uploaded for each client. However, under exceptional circumstances, the stock broker may, at the specific written request of a client, upload the same mobile number/E-mail address for more than one client provided such clients belong to one family (in case of individual clients) or such client is the authorized person of an HUF, Corporate, Partnership or Trust (in case of non-individual clients). Trading members shall ensure that key KYC parameters of the clients are updated on a periodic basis as prescribed by SEBI and latest information of the client is updated in UCC database of the Exchange.

**Delivery of copy of duly completed client registration forms**

- A copy of all the documents executed by the clients shall be given to him free of charge, within 7 days from the date of execution. The stock broker shall obtain the client's acknowledgement of r receipt for the same.
- The trading code, the Unique Client Code allotted to the client, and the email ID furnished by the client for the purpose of receiving electronic contract notes and other details, shall be communicated by the trading member through the KYC form or otherwise in writing to the clients.

**Allotment of two Trading Codes**

For those investors who are required by applicable regulations not to buy or sell without adequate funds or securities to their credit before execution of a transaction, and whose transactions are to be settled by delivery only, brokers may be permitted to allot up to two trading client codes (i.e. for their buy and sell transactions separately). This ensures that each leg of the transaction is treated separately and is not netted. Both trading client codes shall be mapped to the same Unique Client Code of the client. The STT liability for such entities is thus determined on the basis of transactions being settled by delivery only.

**3.2.1.6 Execution of Power of Attorney (PoA) by the Client in favour of the Stock Broker / Stock Broker and Depository Participant**

SEBI vide circular no. CIR/MRD/DMS/13/2010 dated April 23, 2010, circular no. CIR/MRD/DMS/28/2010 dated August 31, 2010 and the SEBI Circular SEBI/HO/MIRSD/DOP/CIR/P/2020/158 dated August 27, 2020, has issued guidelines and clarification for execution of Power of Attorney (PoA) by the client favoring Stock Broker / Stock Broker and Depository Participant to standardize the norms to be followed by stock brokers/ stock broker and depository participants while obtaining PoA from the clients. Details of the same is give below:

I. A Power of Attorney (PoA) is executed by the client in favour of the stock broker /stock broker and depository participant to authorize the broker to operate the client's demat

account and bank account to facilitate the delivery of shares and pay –in/ pay –out of funds.

II. PoA is optional and should not be insisted upon by the stock broker / stock broker depository participant for opening of the client account. No stock broker or depository participant shall deny services to the client if the client refuses to execute a PoA in their favour. However, internet based trading is exempted from this clause.

III. For limited purpose to transfer of funds from the bank account(s) of the clients for the following:
    a. For meeting the settlement obligations of the client(s)/ margin requirements of the client(s) in connection with the trades executed by the clients on the stock exchange through the same Stock Broker.
    b. For recovering any outstanding amount due from the client(s) arising out of clients trading activities on the stock exchanges through the same Stock Broker.
    c. For meeting obligations arising out of the client subscribing to such other products/facilities/services through the Stock Broker like Mutual Funds, Public Issues (shares as well as debentures), rights, offer of shares etc.
    d. Towards monies/fees/charges, etc. due to the Stock Broker/Depository Participant/ Principal payable by virtue of the client using/subscribing to any of the facilities/services availed by the client at his/her instance.

IV. The PoA shall not facilitate the stock broker to do the various actions like Off-market trades between parties other than the related parties, transfer of funds from the bank account(s) of the Clients for trades executed by the clients through another stock broker, Open a broking / trading facility with any stock broker or for opening a beneficial owner account with any depository participant etc.

    SEBI also provided guidelines about execution of PoA. For e.g. PoA should Identify/provide the particulars of the beneficial owner account(s) and the bank account(s) of the client(s) that the stock broker is entitled to operate, PoA should be executed in the name of the concerned SEBI registered entity only and not in the name of any employee or representative of the stock broker /depository participant.

    All off-market transfer of securities shall be permitted by the Depositories only by execution of Physical Delivery Instruction Slip (DIS) duly signed by the client himself or by way of electronic DIS. The Depositories shall also put in place a system of obtaining client's consent through One Time Password (OTP) for such off market transfer of securities from client's demat account.

### 3.2.1.7 Execution of 'Demat Debit and Pledge Instruction' (DDPI) for transfer of securities towards deliveries / settlement obligations and pledging / re-pledging of securities[43]

[43] https://www.sebi.gov.in/legal/circulars/apr-2022/execution-of-demat-debit-and-pledge-instruction-ddpi-for-transfer-of-securities-towards-deliveries-settlement-obligations-and-pledging-re-pledging-of-securities_57546.html

While executing a PoA, authorization is given by client to the stock broker / stock broker and depository participant, to access the Beneficial Owner (BO) account of the client to meet settlement obligations of the trade executed by the client. In order to make the process more transparent and simpler, the following conditions shall be made part of a separate document viz. 'Demat Debit and Pledge Instruction' (DDPI).

- Transfer of securities held in the beneficial owner accounts of the client towards Stock Exchange related deliveries / settlement obligations arising out of trades executed by clients on the Stock Exchange through the same stock broker.
- Pledging / re-pledging of securities in favour of TM/ CM for the purpose of meeting margin requirements of the clients in connection with the trades executed by the clients on the Stock Exchange.
- Mutual Fund transactions being executed on stock exchange order entry platforms and which shall be in compliance with SEBI circulars SEBI/HO/IMD/IMD-I DOF5/P/CIR/2021/634 dated October 04, 2021, SEBI/HO/IMD/IMD-I DOF5/P/CIR/2021/635 dated October 04, 2021 and SEBI/HO/IMD/IMD-I DOF5/P/CIR/2022/29 dated March 15, 2022 or any other circular which may be issued in this regard; and
- Tendering shares in open offers which shall be in compliance with SEBI circular SEBI/HO/CFD/DCR-III/CIR/P/2021/615 dated August 13, 2021 or any other circular which may be issued in this regard.

The DDPI shall serve the same purpose of PoA and significantly mitigate the misuse of PoA. The use of DDPI shall be limited only for the purposes as mentioned above.

The client may use the DDPI or opt to complete the settlement by issuing physical Delivery Instruction Slip (DIS) or electronic Delivery Instruction Slip (eDIS) themselves. The existing PoAs shall continue to remain valid till the time client revokes the same. Thus, the stock broker/stock broker and depository participant shall not directly / indirectly compel the clients to execute the DDPI or deny services to the client if the client refuses to execute the DDPI.
*Hence, with the implementation of this circular, PoA shall no longer be executed for the conditions specified above.*

For further information participants may refer SEBI circular.

### 3.2.1.8 Brokerage

Brokerage are charges that are mutually agreed between member and client subject to maximum permissible by the Exchange and brokerage rate shall be mentioned in the tariff sheet. Brokerage firms have elaborate commission module (brokerage) to attract and retain clients. The Client shall pay to the stock broker brokerage and statutory levies as are prevailing from time to time and, as they apply to the Client's account, transactions and to the services that stock broker renders to the Client. The stock broker shall not charge brokerage exceeding the maximum brokerage permissible under the rules, regulations and bye-laws of the relevant stock exchanges and/or regulations of SEBI. Given below are the rules for charging brokerage.

- Brokerage rule for Equity/Capital Market segment:
    - Maximum brokerage that brokers can charge is 2.5% of the trade value exclusive of statutory levies.
    - If the value of share is Rs.10/- or less, a maximum brokerage of 25 paise per share can be collected.
    - There is no minimum brokerage requirement specified.
- Brokerage rule for Derivatives segment:
    - Brokerage rule for future is similar to the equity segment
    - Trading member shall charge brokerage for option contracts on the premium amount at which the option contract was bought or sold and not on the strike price of the option contract. In the case of options contracts, maximum brokerage can be 2.5% of the option premium or Rs.100/- per lot whichever is higher.

Trading member can be a full service broker, discount broker or an online broker. Commission charged can be different for different types of brokers.

- Full service broker charges higher commission
- Discount brokers charge a much lower commission
- Online brokers cater to niche segment of retail clients.
    - Commission charged is lesser than what would be charged for a client placing orders through a broker.
- Brokers also use multiple commission schemes such as
    - Volume based commission
    - Slab wise commission or
    - Scrip wise commission.

Commission charges may differ for day trades versus delivery transactions.

In order to bring more transparency SEBI advised members to display details of brokerage to the investor on the "order placement window" on their IBT/WT application prior to placement of order.

### 3.2.2 Order Management

Order management consists of entering orders, order modification, order cancellation and order matching. The main components of an order are:

- Price
- Time
- Quantity / No. of Contract
- Security/Contract (What to buy and what to sell))
- Action (Buy / Sell)
- Client identity (UCC)/ PAN

A trading member can enter various types of orders depending upon trader/client requirements. The order conditions are broadly classified into three categories: price related conditions, time-related conditions, and quantity related conditions. We will see about the order condition in following section. Trading members are allowed to enter order during market hours only. Following are some examples of order entry:

| Security Details Symbol/Code/Name | | Buy / Sell | Quantity | Price | Time Condition | Pro / Cli | UCC & PAN | CP Code |
|---|---|---|---|---|---|---|---|---|
| ABCDE | 12345 | B | 5 | 76.50 | Day | Cli | A001 XXXXXXXXXX | - |

### 3.2.2.1 Types of order

Price, time and quantity are three major components of an order. A stock broker can enter various types of orders depending upon his/her requirements. These conditions are broadly classified into three categories: price related conditions, time-related conditions, and quantity related conditions.

**A. <u>Price Condition:</u>**

**<u>Market Order - Basic Trade</u>**

A market order is where a trader purchases or sells their security at the best market price available across the market depth to complete the order quantity. In the market order there is no need to specify the price at which a trader wants to purchase or sell. There are two variations on the market order—market order without protection and Market with protection order. The market order without protection means that the trades are executed at the best available price/s in the market at that point in time. The second type of market

order i.e. market with protection order is a combination of market and limit order. It allows the market order to be executed till a specified level mentioned by trader. The risk of an order getting executed at any price is protected by using such order.

**Example 3.1: Illustration of a typical market order**

Order is placed to buy 100 shares of ABC Industries Ltd. "at Market". The order book snapshot looks like as below:

| Buy Qty. | Buy Price | Sell Price | Sell Qty. |
|---|---|---|---|
| 1,606 | 807.55 | 807.60 | 100 |
| 13 | 807.50 | 807.65 | 119 |
| 383 | 807.45 | 807.70 | 184 |
| 78 | 807.40 | 807.75 | 42 |
| 1 | 807.35 | 807.85 | 86 |

In this current scenario, the incoming market order will get matched with the best sell order in the book which is 100 shares @ Rs.807.60 and a trade will take place for 100 shares at Rs.807.60.

**Limit Order -**

Limit orders involve setting the entry or exit price and then aiming to buy at or below the market price or sell at or above it. Unlike market order, the trader here needs to specify price. They of course can be changed any time before execution. Reaching these limits/targets is not always possible and sometimes the orders do not go through. Limit orders are very common for online traders.

**Example 3.2: Illustration of a typical limit order**

Order is placed to buy 200 shares of ABC Industries Ltd at Rs.807.60. The order book snapshot looks like as below:

| Buy Qty. | Buy Price | Sell Price | Sell Qty. |
|---|---|---|---|
| 1,606 | 807.55 | 807.60 | 100 |
| 13 | 807.50 | 807.75 | 119 |
| 383 | 807.45 | 807.80 | 184 |
| 78 | 807.40 | 807.85 | 42 |
| 1 | 807.35 | 807.90 | 86 |

In this current scenario, the incoming limit order will get matched with the best sell order in the book which is 100 shares @ Rs.807.60 and a trade will take place for 100 shares at

Rs.807.60. Orders lying unmatched in the system are 'passive' orders and orders that come in to match the existing orders are called 'active' orders. It should be noted that the order is always matched with the passive order price. The balance buy order for 100 shares @ Rs.807.60 will sit in the order book on the buy side as the best buy order. The revised order book snapshot after the trade match will look as follows:

| Buy Qty. | Buy Price | Sell Price | Sell Qty. |
|---|---|---|---|
| 100 | 807.60 | 807.75 | 119 |
| 1,606 | 807.55 | 807.80 | 184 |
| 13 | 807.50 | 807.85 | 42 |
| 383 | 807.45 | 807.90 | 86 |
| 78 | 807.40 | 807.95 | 12 |

**Stop Orders (orders with stop loss triggers)**

The one that allows the Trading Member to place an order which gets activated only when the market price of the relevant security reaches or crosses a threshold price. Until then the order does not enter the market.
In stop order, the client enters two prices: one is trigger price and the other is limit/market price. A stop order can best be explained with an example. Suppose a trader has a short term (say, for a day), bullish view on a stock, he may buy the stock at say Rs.100 per share in the early hours of trading session. If the stock price moves upwards as per his expectation, he may sell the stock, say at Rs.110 and close his position. The stock price can also move downwards much against expectations of the trader. It may so happen that the trader may have limited risk appetite and does not want to incur loss of more than Rs.5 per share. In such a scenario, trader can give stop loss sell order with trigger price of Rs.96 and limit price of Rs.95. When the stock price starts moving downwards, as soon as it hits price of Rs.96, the sell order of Rs.95 will automatically get triggered. Any further downward movement in price will not affect the trader as he has already limited his loss on the position.

A buy order in the Stop Loss book gets triggered when the last traded price in the normal market reaches or exceeds the trigger price of the order.

A typical sell stop loss order example:

- Original transaction-Bought 400 shares of ABC Industries Ltd. (ABC) at Rs.830.
- If the price falls below the purchase price, the investor will start clocking a loss.
- Investor may place a sell stop loss order at a trigger price of Rs.800. When the price of ABC drops to Rs.800 or below, sell stop loss order will get triggered.
- Order is then placed in the market to sell 400 shares of ABC.

- It can be triggered as a market order, or as a limit order
- If the investor had specified a limit price (which can be equal to or less than trigger price), for example in this case, Rs.790
- In the case of stop loss limit order, once triggered, the order will be placed in the market for sell ABC 400 shares at Rs.790.
- It will match only if a corresponding buy order exists for Rs.790/- or better.
- If it is stop loss market order, once triggered it will match with the best counter order available.

A typical buy stop loss order example:

- Original transaction – Sell 400 shares of ABC Industries Ltd (ABC) at Rs.830.
- If the price goes above the selling price, the investor will start clocking a loss.
- Buy stop loss order is used to anticipate potential loss. Investor may place a buy stop loss order at a trigger price of say Rs.880.
- When ABC price reaches Rs.880 or above, the buy stop loss order will get triggered.
- An order will be placed in the market to buy 400 shares of ABC.
- It can be triggered as a market order, or as a limit order.
- If the investor had specified a limit price (which can be equal to or more than trigger price), for example in this case, the limit price could be Rs.890.
- In the case of stop loss limit order, when the stop loss order is triggered, the order will be placed in the market for buying 400 ABC shares at Rs.890/-. It will match only if a corresponding sell order exists for Rs.890/- or better.
- If it is stop loss market order, once triggered it will match with the best counter order available.

The variations in the three orders require traders to be well aware of the options when trading. Studying the stock and predicting the trend accurately is very important.

**B. <u>Time Condition:</u>**

DAY - A Day order, as the name suggests, is an order which is valid for the day on which it is entered. If the order is not matched during the day, the order gets cancelled automatically at the end of the trading day.

IOC - An Immediate or Cancel (IOC) order allows a Trading Member to buy or sell a security as soon as the order is released into the market, failing which the order will be removed from the market. Partial match is possible for the order, and the unmatched portion of the order is cancelled immediately.

**Example 3.3: Illustration of a typical IOC order**

Order is placed to buy 200 shares of ABC Industries Ltd. at Rs.807.60 immediate or cancel. The order book snapshot looks like as below:

| Buy Qty. | Buy Price | Sell Price | Sell Qty. |
|---|---|---|---|
| **1,606** | 807.55 | 807.60 | 100 |
| **13** | 807.50 | 807.75 | 119 |
| **383** | 807.45 | 807.80 | 184 |
| **78** | 807.40 | 807.85 | 42 |
| **1** | 807.35 | 807.90 | 86 |

In this current scenario, the incoming limit order will get matched with the best sell order in the book which is 100 shares @ Rs.807.60 and a trade will take place for 100 shares at Rs.807.60. It should be noted that the order is always matched with the passive order price, in this case as the sell order is the passive order, matching takes place at Rs.807.60. The balance buy order for 100 shares @ Rs.807.60 will be cancelled as it is an IOC order and there is no match for the remaining 100 shares.

GTC - A Good Till Cancelled (GTC) order is an order that remains in the system until it is cancelled by the Trading Member. It will therefore be able to span trading days if it does not get matched. The maximum number of days a GTC order can remain in the system is notified by the Exchange from time to time.

GTD - A Good Till Days/Date (GTD) order allows the Trading Member to specify the days/date up to which the order should stay in the system. At the end of this period the order will get flushed from the system. Each day/date counted is a calendar day and inclusive of holidays. The days/date counted are inclusive of the day/date on which the order is placed. The maximum number of days a GTD order can remain in the system is notified by the Exchange from time to time.

Cancel on Logout (COL): If member / user entered order with COL, all outstanding order of the user will get cancelled once user logs out from the TWS.

Note: Currently, GTC and GTD orders are not available on the system as per SEBI directives.

**C. <u>Quantity Condition:</u>**

Disclosed Quantity (DQ)- An order with a DQ condition allows the Trading Member to disclose only a part of the order quantity to the market. For example, an order of 1000 with a disclosed quantity condition of 200 will mean that 200 is displayed to the market at a time. After this is traded, another 200 is automatically released and so on till the full order is executed. The Exchange may set a minimum disclosed quantity criteria from time to time.

MF - Minimum Fill (MF) orders allow the Trading Member to specify the minimum quantity by which an order should be filled. For example, an order of 1000 units with minimum fill 200 will require that each trade be for at least 200 units. In other words, there will be a maximum of 5 trades of 200 each or a single trade of 1000. The Exchange may lay down norms of MF from time to time.

AON - All or None orders allow a Trading Member to impose the condition that only the full order should be matched against. This may be by way of multiple trades. If the full order is not matched it will stay in the books till matched or cancelled.

Note: Currently, AON and MF orders are not available on the system as per SEBI directives.

Other conditions

- Pro: 'Pro' means that the orders are entered on the trading member's own account.
- Cli: 'Cli' means that the trading member enters the orders on behalf of a client.

**Proprietary Trading**

Trading members are also allowed to trade on own behalf. To facilitate the same Stock Exchanges, provide facility of placing order on proprietary (pro) account. Facility of placing orders on proprietary account through trading terminals shall be extended only at one location of the members as specified / required by the members. Trading terminals located at places other than the above location shall have a facility to place orders only for and on behalf of a client by entering client code details as required / specified by the Exchange / SEBI. Proprietary trading allowed from more than one location is subject to certain conditions. In case any member requires the facility of using "pro-account" through trading terminals from more than one location, such member shall be required to submit an undertaking to the Stock Exchange stating the reason for using the "pro-account" at multiple locations and the Stock Exchange may, on case to case basis after due diligence, consider extending the facility of allowing use of "pro-account" from more than one location.

With a view to increase the transparency in the dealings between the broker and the client, every broker shall disclose to his client whether he does client based business or proprietary trading as well. The broker shall disclose this information upfront to his new clients at the time of entering into the Know Your Client agreement.

A stock broker of an exchange cannot deal with the brokers of the same exchange either for proprietary trading or for trading on behalf of clients, except with the prior permission of the exchange. The Stock Exchanges while giving such permission, shall consider the reasons stated by the brokers for dealing with brokers of the same exchange and after carrying

out due diligence allow such brokers to deal with only one stock broker of the same exchange. A stock broker of an exchange can deal with only one broker of another exchange for proprietary trading after intimating the names of such stock broker to his parent Stock Exchange.

#### 3.2.2.2 Process of order routing through the Exchanges

Once the order is entered and confirmed by the client/dealer at his trading terminal and verified by the broker software, the order is routed to the Exchange for its execution. The Exchange system allots a unique order number for all orders received in the system. This is given as order confirmation along with the time stamp to the broker.

The order gets executed at the Exchange depending upon the type of order. If the order is a market order it gets executed immediately subject to availability of counter order. If it is a limit order it is matched against appropriate counter orders. Once the order is matched, a trade is said to be executed. As soon as a trade is executed the trade confirmation message will be automatically available on the trading terminal of broker.

All orders can be modified or cancelled during the trading hours and pre-open market stage provided they are not fully executed. For the orders, which are partially executed, only the open or unexecuted part of the order can be cancelled/modified.

#### 3.2.2.3 Continuous Order Matching Principle:

Stock Exchanges in the capital market segment follow continuous order matching based on price-time priority during the regular session of the normal market. The salient features are given below:

- Matching based on Price – Time priority
- Price: The best price orders are matched first. For order matching, the best buy order is the one with the highest price, and the best sell order is the one with the lowest price.
- Time: In cases where there is more than one order at the same price, the order that entered the system first will get priority at the time of matching
- Passive Orders: Orders lying unmatched in the system are 'passive' orders
- Active Orders: Orders that enter the system and attempt to match with existing orders are called 'active' orders.
- Orders are always matched at the passive order price.
- Matching of active order may be against single or multiple passive orders
- Quantity is not a factor in determining matching priority.

Let us take an example here to better understand this. A sample of the order book is given below for understanding.

| Buy Quantity | Buy Price | Sell quantity | Sell Price |
|---|---|---|---|
| 50 | 121.20 | 50 | 121.50 |
| 100 | 121.10 | 200 | 121.80 |
| 25 | 120.90 | 3000 | 122.10 |
| 500 | 120.80 | 1000 | 122.20 |
| 5000 | 120.00 | 200 | 122.60 |

These quotes given in the table above are visible to clients. Now if a buy market order comes with an order quantity of 50 it gets executed for a price of Rs. 121.50 and the order book entries on the sell side moves up by one notch i.e. the Rs. 121.80 order comes to top. On the other hand if a limit order with a sell price of Rs. 121.20 for a quantity of 500, only 50 shares get executed and the order for remaining 450 stays at the top on the sell side at Rs. 121.20.

All orders come as active orders into the order book. If they get a match they will be executed immediately, else they will be entered into the order book according to price and time as passive orders.

Let us take another example:

| Buy Qty./Lot | Buy Price | Sell Price | Sell Qty./Lot |
|---|---|---|---|
| 1,606 | 807.55 | 807.60 | 100 |
| 13 | 807.50 | 807.75 | 119 |
| 383 | 807.45 | 807.80 | 184 |
| 78 | 807.40 | 807.85 | 42 |
| 1 | 807.35 | 807.90 | 86 |

Order is placed to buy 200 shares at Rs.807.65. In this current scenario, the incoming limit order will get matched with the best sell order in the book which is 100 shares @ Rs.807.60 and a trade will take place for 100 shares at Rs.807.60 and not at Rs. 807.65. It should be noted that the order is always matched with the passive order price, in this case as the sell order is the passive order, matching takes place at Rs.807.60. The balance buy order for 100 shares @ Rs.807.65 will sit in the order book on the buy side as the best buy order.

**Call Auction Matching Principle:**

The call auction is another order matching mechanism used by stock exchanges, primarily to establish a fair opening price for securities, or for trading in illiquid stocks. Unlike the continuous matching where trades happen instantly, a call auction batches all orders together at specific times and executes them at a single, uniform price.

The core principle of a call auction is to aggregate liquidity (all buy and sell orders) at a specific time to determine an equilibrium price that maximizes the number of trades (in terms of quantity).
The process generally follows these phases:

- Order Entry Window: Market participants can place, modify, or cancel their buy and sell orders within a specific timeframe. During this phase, no trades are executed, but the order book is visible to participants to aid price discovery.
- Order Matching and Price Determination: After the order entry window closes, the exchange's system calculates a single "clearing price" or "equilibrium price". This is the price point where the maximum volume of shares can be matched and traded.
- If more than one price meets the criterion, the equilibrium price is the one that result in minimum unmatched order quantity.
- If multiple prices have the same minimum unmatched quantity, the equilibrium price is the one closest to the reference price (for e.g. previous day's closing price).
- If the reference price is the mid-value of a pair of prices closest to it, then the reference price itself will be taken as the equilibrium price.
- Trade Execution: All eligible orders are executed at this single, uniform equilibrium price. Orders that cannot be matched are generally cancelled or carried forward to the next session, depending on exchange rules.

**Example**

| Share Price | Order Book | | Cumulative Schedule | | Maximum Tradable Quantity |
|---|---|---|---|---|---|
| | Buy | Sell | Demand | Supply | |
| 103 | 13500 | 11500 | 50500 | 11500 | 11500 |
| 104 | 9500 | 9800 | 37000 | 21300 | 21300 |
| **105** | **12000** | **15000** | **27500** | **36300** | **27500** |
| 106 | 6500 | 12000 | 15500 | 48300 | 15500 |
| 107 | 5000 | 12500 | 9000 | 60800 | 9000 |
| 108 | 4000 | 8500 | 4000 | 69300 | 4000 |

Maximum tradeable quantity of 27500 shares at Rs. 105. Hence EP is Rs. 105/-. Buyers with price 105 & above will get security at Rs. 105/- and Seller with price 105 & below will receive at Rs. 105/-

### 3.2.3 Order Modification/ Cancellation

Sometimes in a moving market, orders need to be changed in terms of the price and quantity as per the client's requirement. All the orders can be modified till the time they are not fully executed.

Due to some problems in the moving market or when one does not want to buy or sell shares, then orders need to be cancelled. In this case only those orders can be cancelled during market hours which have not been fully or partially executed.

### 3.2.4 Trade execution

Execution of trade occurs when a buyer and seller reach an agreement pertaining to the terms and price of a trade, and the order to buy or sell a security is completed after the same is matched on the Exchange platform. Once the order is executed it turns into trade and exchange sends notification of the trade to the broker. The broker in turn communicates these trades to the client either immediately or end of day. Official communication from broker is done to the client through contract note.

**Trade modification** is allowed for parameters like client code and custodian participant code. However, there are certain conditions and timings for such modifications as given below:

- Stock Exchanges may allow modifications of client codes of non-institutional trades only to rectify a genuine error in entry of client code at the time of placing/modifying the related order. The Stock Exchange shall conduct a special inspection of the trading member to ascertain whether the modifications of client codes are being carried on as per the strict objective criteria set by the Stock Exchange. Shifting of trades to the error account of broker would not be treated as modification of client code, provided the trades in error account are subsequently liquidated in the market and not shifted to some other code.
- Further, brokers shall disclose the codes of accounts which are classified as 'error accounts' to the Stock Exchanges. Each broker should have a well-documented error policy approved by the management of the broker. Stock Exchanges shall periodically review the trades flowing to the error accounts of the brokers.
- The Stock Exchanges shall levy a penalty on trading members wherever applicable and credit the same to its Investor Protection Fund. Stock Exchanges may waive penalty for a client code modification where stock broker is able to produce evidence to the satisfaction of the stock exchange to establish that the modification was on account of a genuine error.
- Proprietary trades shall not be allowed to be modified as client trade and vice versa.

Modification between client codes of two entities which are of the institutional category will be allowed only if the modification from both client codes is from different schemes / sub-accounts of / managed by the same Institution. Such modifications shall not be subject to penalty.

Any modification between two client codes which are of institutional category and do not satisfy the above criteria, i.e., modification between two unrelated institutional clients will be subject to penalty.

Members can modify the Custodial Participant Code (CP Code) on the trade day during trading hours as per the time stipulated by Stock Exchanges and Clearing Corporation.

**Trade annulment**[44]: Trading members are allowed to provide trade annulment request on trading system. The request should be submitted within 30 minutes from trade execution. However, stock exchange may consider requests received after 30 minutes, but no longer than 60 minutes, only in exceptional cases and after examining and recording reasons for such consideration. Trade annulment request should satisfy certain condition for further processing. A fee based on value of trade(s) for which annulment is requested, subject to minimum and maximum fee shall be charged as annulment application fee for accepting the request. Examination of trade(s) for annulment can also be taken suo moto by stock exchange.

As per SEBI guideline on Trade Annulment, Stock exchanges shall charge an application fee equal to 5% of the value of trade(s) for accepting an annulment request from a stock broker, subject to minimum fee of Rs. 1 lakh and maximum fee of Rs.10 lakhs. Stock exchanges may suitably increase the upper limit of the application fee as deemed necessary to discourage frequent or frivolous requests for annulment. The amount realised as application fee shall be credited to the "Investor Protection Fund" of the concerned stock exchange.

## 3.3 Middle Office Operations

The middle office, as the name implies, is a hybrid function between the front and back office. The middle office handles validations, bookings and confirmations. Risk Management and Surveillance typically forms the main function of the middle office.

### 3.3.1 Risk Management & Surveillance

Any transaction or behaviour, whether it is buying, selling or instigating to wilfully produce an abnormal effect on prices and/or volumes, goes against the fundamental objective of protecting the interest of the investors of the securities markets. Here the risk management

[44] Circular No. CIR/MRD/DP/15/2015 dated July 16, 2015

system plays a crucial role. An efficient risk management system is integral to an efficient settlement system. As we know that obligation to settle the trades lies with the broker. If any client makes any trade default, then the same has to be made good by the broker to the clearing corporation. When orders are accepted and sent to exchange these orders go through various risk management checks for clients. The broker system should have an on-line risk management capability for all orders placed on the Exchange platform. Further, brokers should have various trading limits (like Order Quantity and Value Limits, User / Branch Order Limit, Order Price limit, etc.) on the system and only such orders which are within the parameters specified by the risk management system be allowed to be pushed into exchange trading platform. Margin is an amount that clearing corporations levy on the brokers for maintaining positions on the exchange. The amount of margin levied is proportional to the exposure and risk the broker is carrying. Since positions may belong to a broker's clients, it is the broker's responsibility to collect the margin upfront from clients and allow trading to client based on the collateral provided by the client. The broker system should have capability to generate reports relating to margin requirements, payments, and delivery obligations. The goal of a broking firm's risk management system is to measure and manage its own and its client's exposure to various risks identified as central to its operations. Broker system should assess the risk of the client as soon as the order comes in, further broker can have system-based control on the trading limits of clients, and exposures taken by clients. Brokers are required to set pre-defined limits on the exposure and turnover of each client. SEBI/Stock Exchanges have specified various system/risk management requirement based on the type of broker. For example, Brokers who trade through exchange provided terminals, brokers trade through CTCL, IBT, STWT, SOR and brokers who use Algorithmic Trading facility. For each risk category, the broking firm must employ procedures to measure and manage firm-level exposure. These are:

a) Establishing Standards and Reports
b) Imposing Position Limits
c) Set Investment Guidelines and Strategies
d) Systems for Reporting Compliance with Established Policies and Procedures
e) Assessment of the Effectiveness of the Strategies, Policies and Procedures

#### 3.3.1.2 Types of Risk for Members

**Operational risk** is the risk of monetary loss resulting from inadequate or failed internal processes, manual and systems error or external events. For the stock broker, operations risks are essentially risk arising on account of handling of client assets, regulatory non-compliance, trading error, non-payment for buying or selling a scrip, non-delivery of scrip(s), denial of matched order by clients, sudden closure of banks where funds are deposited etc. Operational risk encompasses the risk of loss due to the breakdown in controls within the firm including, but not limited to, unidentified limit excesses, unauthorized trading, fraud in

trading or in back office functions including inadequate books and records and a lack of basic internal accounting controls, inexperienced personnel, and unstable and easily accessed computer systems.

**Market risk** refers to the possibility of incurring large losses from adverse changes in financial asset prices such as stock prices. For the stock broker, market risks are essentially risk arising on account of concentration of client collateral in stocks/sectors, brokers own investment in stocks/sectors etc. This risk entails the erosion of value of marketable securities and assets, due to factors beyond an enterprise's control. Market risk is usually affected by economic developments and political destabilization such as a rising fiscal gap, national debt, terrorism, energy price shocks, increase in interest rates, all resulting in a drop in equity prices. Market risk can also include the risks associated with the cost of borrowing securities, dividend risk, and correlation risk.

**Credit risk** is the risk of default on a debt that may arise from a borrower failing to make required payments. The credit risk for broker can arise on account of Loans to Group Companies/ Related Parties, debit balance of clients, funding of clients, short collection of margins, Non-confirmation of DVP trade by custodian etc. Credit risk can be minimized by risk management and controls and procedures that require counterparties to maintain adequate collateral, make margin payments, and have contractual provisions for netting.

**Legal risk** arises from the possibility that an entity may not be able to enforce a contract against another party. Legal risk involves the potential illegality of the contract, as well as the possibility that the other party entered into the contract without proper authority.

**Systemic Risk** refers to (1) the scenario that a disruption at a firm, in a market segment, or to a settlement system could cause a "domino effect" throughout the financial markets toppling one financial institution after another or (2) a "crisis of confidence" among investors, creating illiquid conditions in the marketplace. Systemic risk encompasses the risk that failure in one firm or one segment of the market would trigger failure in segments of or throughout the entire financial markets.

**Technology risk** which includes technical glitches and cyber-attacks.

A stock broking firm must identify factors that can trigger operational, market, legal, systemic and credit risk. It needs to establish procedures so that risk management begins at the point nearest to the assumption of risks. This means adapting trade-entry procedures, customer documentation, client engagement methods, trading limits, and other normal activities to maintain management control, generate consistent data, and eliminate needless exposure to risk.

### 3.3.2 Surveillance Mechanism

With regards to "Monitoring of unauthenticated news circulated by SEBI Registered Market Intermediaries through various modes of communication" SEBI directs intermediaries to implement a strict internal code of conduct prohibiting staff from circulating unverified market rumors. Access to social media and messaging platforms must be supervised, with all usage logs maintained as official records. Furthermore, any market-related news must be approved by the Compliance Officer before forwarding, otherwise, both the employee and the officer will face SEBI enforcement action.

SEBI regulated market intermediaries also required to report to Stock Exchanges regarding violations under SEBI (Prohibition of Insider Trading) Regulations, 2015 relating to the Code of Conduct (CoC). SEBI (Stock Brokers) Regulations, 2026, Chapter IV provided guidelines on the "Institutional Mechanism for Prevention and Detection of Fraud or Market Abuse."[45] Accordingly, it has been decided that stock brokers shall comply with the obligations and mechanisms laid down in Chapter IV of the Stock Broker Regulations. Key requirement includes:

- Systems for the surveillance of trading activities and internal controls
- Clearly documented policies and procedures relating to surveillance systems and internal controls
- Obligations regarding the prevention and detection of fraud or market abuse
- Escalation and reporting mechanisms
- Whistle Blower Policy

A few important points related to surveillance are provided below.[46]

To comply with Anti-Money Laundering laws (PMLA), Trading Members must fulfill core responsibilities such as Client Monitoring, and implementing mandatory warnings on trading software. Trading members must have a formal Surveillance Policy in place to track client behavior, block manipulative trades, and warn investors about risky securities covering all aspects of their business models & services.

To curb "reversal trades"—non-genuine transactions designed solely to transfer profits/losses between parties or create artificial market volume, -Exchanges have introduced the "Reversal Trade Cancellation Mechanism" (RTCM).This mechanism operates

[45]https://www.sebi.gov.in/legal/circulars/jul-2024/measures-to-instil-confidence-in-securities-market-brokers-institutional-mechanism-for-prevention-and-detection-of-fraud-or-market-abuse_84588.html

[46] or further details, participants may refer to the consolidated circular provided by the Surveillance department of the Stock Exchanges.

on an intraday basis to cancel trades that satisfy the criteria of a reversal transaction. Trading members are advised to take note of the same.

## 3.4 Back Office Operations

The back office exists for three reasons: confirmation, payments, settlements and accounting. In other words, the back office monitors the post-market processing of transactions. The back office is where the trade ends.

### 3.4.1 Trade Enrichment

Trade enrichment is defined as process of including additional information in one instruction in a trade which is already being executed.

Trade Enrichment is performed automatically after each trade execution. In this step, all necessary details for the clearing of futures and option contracts, or the settlement of cash securities are added.

For the purpose of back office operations, the back-office systems maintain masters relating to brokerage rate client wise, Goods and services tax (GST), stamp duty and Securities Transaction Tax charge tables.

When the trade data is uploaded into the back office, the above information is appended to every trade. Post upload of data with all the relevant information, the back-office process is carried out to arrive at:

- Client wise brokerage
- Client wise obligation for securities and funds
- All the relevant tax amounts to be collected and paid

Back office systems generate obligations towards exchange settlements as well as client wise contract notes, settlements and tax obligations.

### 3.4.2 Trade Allocation

In the case of institutional trades, the front office may enter a single order for a particular client with CP code “INST” and subsequently distribute it across various sub schemes of the client at the back office end.

For example, hedge fund makes a trade, and manages several portfolios. Often, they will choose to allocate their trade to various portfolios for a number of reasons. Trade allocation

specifically refers to this process, or more specifically, how the trade is allocated (pro rata, all or nothing, etc).

Once the trade data is received at the back office, the user will also receive deal sheets from the front office team in terms of details of allocation to individual schemes. Based on these instructions, the back office user will then allocate the trade to individual schemes within the parent fund and generate appropriate contract note. Brokers also need to upload the allocation details to clearing corporation.

### 3.4.3 Clearing and Settlement Process

Clearing and Settlement is a post trading activity that constitutes the core part of equity trade life cycles. After the trade is confirmed (when securities are obliged to change hands) the broker who is involved in the transaction issues a contract note at the end of the trade day. The contract note issued by broker, informs the client of his obligations.

Clearing house/corporation is an entity through which settlement of securities takes place. The details of all transactions performed by the brokers are made available to the Clearing House/Corporation by the Stock Exchanges. The Clearing House/Corporation gives an obligation report to the brokers (clearing member) and custodians who are required to settle their money/securities obligations within the stipulated time period, failing which they are required to pay penalties. This obligation report serves as statement of mutual contentment. T+1 rolling settlement was completely implemented in the Indian securities market w.e.f. January 27, 2023.

Typical normal market settlement cycle (T+1 rolling settlement) for cash market is given in Table 3.1.

**Table 3.1**

| | **Activity** | **Day (For T+1 Rolling Settlement)** |
|---|---|---|
| Trading | Rolling Settlement Trading | T |
| | Download provisional obligation | T |
| Clearing | Custodial Confirmation on or by | T +1 working day |
| | Download of final obligation to Member and Custodian | T +1 working day |
| Settlement | Securities and Funds pay in | T+1 working day |
| | Securities and Funds pay out | T+1 working day |
| | Valuation Debit | T+1 working day |
| Post Settlement | Auction on or by | T+1 working day |
| | Auction settlement on or by | T+2 working day |

In a T+1 rolling settlement, for all trades executed on trading day i.e., T day the obligations are determined on the T+1 day and settlement on T+1 basis i.e., on the next working day. For arriving at the settlement day all intervening holidays, which include bank holidays, Exchange holidays, Saturdays and Sundays are excluded. We will discuss in detail about clearing and settlement in chapter 5 & 6.

Member play a dual role in clearing and settlement, as summarize below:

1.Relationship with clients (Trading Member–Client)

•After a trade is executed on the exchange, the trading member (broker) issues a contract note to the client detailing the trade price, charges, and net obligations.

•The client must fulfill their obligation to the trading member. Buyers must fund their purchase (transferring funds to the broker's designated client bank account), and sellers must deliver securities from their demat account( typically via earmarking/block mechanism for settlement)

•The trading member acts as the client's agent, consolidating all client obligations, collecting margins. The members remains responsible to the clearing corporation for the settlement, even if a client defaults, subject to established risk controls

2.Relationship with Clearing Corporation (clearing member–CC)

•The exchange sends matched trade data to the clearing corporation (CC), which novates the trades. The CC becomes the central counterparty, guaranteeing settlement between all trading/clearing members.

•The clearing corporation calculates the net funds and securities obligations for each clearing member, issues pay -in/pay- out schedules, and requires margins and other risk collateral to control counterparty risk.

•On settlement day (T+1), clearing members arrange the pay-in of securities and funds through clearing bank and depositories. The CC then effects the pay -out; funds are credited to the members' accounts, and securities are credited directly to client demat account.

### 3.4.4 Accounting

The stock brokers are required to maintain books of account as prescribed by the Securities Contracts (Regulation) Rules 1957, SEBI (Stock brokers) Regulations 2026, and requirements of Stock Exchanges. These are to be maintained for a minimum period as specified under the various regulations. In case such documents are maintained in electronic form, provisions of Information Technology Act, 2000 in this regard shall be complied with.

#### 3.4.4.1 Different types of accounts, records, etc.

The broker has to keep and maintain the required books of accounts, records, documents as per Rule 15 of the Securities Contracts (Regulation) Rules 1957 and Regulation 15 of SEBI (Stock Broker) Regulations, 2026. Stock brokers are required to maintain separate books for each Stock Exchange in which they operate. Further, for any Stock Exchange, a separate set of ledger accounts of clients has to be maintained for each particular segment of the Exchange in which the stock broker operates. The stock brokers are also required to maintain client-wise separate books of accounts. With respect to segments forming part of clearing corporation interoperability, client financial ledgers can be prepared Segment wise and consolidated across Exchanges. However, during inspections, Stock Brokers should be able to demonstrate the break-up of trades (Segment-wise & Exchange-wise) for the bills so posted.

The books that shall be maintained by a broker include, register of transactions (sauda book), clients ledger, general ledger, journals, cash book, bank pass book, securities register, counterfoils or duplicates of contract notes, margin deposit book, KYC, client account opening form etc. Some of these books/transaction records are briefly discussed below.

- The ***register of transactions (sauda book)*** is to include each transaction effected. This would show the name of the security, its value, rates gross and net of brokerage and names of the clients etc.

- The ***client's ledger***, as the name suggests, has the details of all clients, and their transactions through the broker.

- The ***general ledger*** accounts for all general transactions including expenses, overheads salaries, petty cash, etc.
- The ***journal*** is the accounting book of the general ledger. Any adjustment entries for e.g., interest receivable, etc., are accounted here.

- The ***cash book and bank pass book*** contain records of all cash and cheque transactions and are normally balanced daily.

- Documents register containing, inter alia, particulars of securities received and delivered in physical form and the statement of account and other records relating to receipt and delivery of securities provided by the depository participants in respect of dematerialized securities.
- A ***contract note*** is a confirmation of trade done on a particular day for and on behalf of a client. A contract note issued in the format and manner prescribed by the Exchanges establishes a legally enforceable relationship between the stock broker and the client in respect of settlement of trades executed on the Exchange as stated in the contract note.

- Stock brokers are required to maintain duplicate copy or counter foil of the contract notes.
- Written consent of clients in respect of contracts entered into as principals.
- The ***margin deposit book*** contains details of margins paid and collected and payable and collectable.
- Member's contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members.
- Client account opening form in the format as may be specified by the Board.

As per regulation 16 of the SEBI (Stock Broker) Regulations, 2026, every stock broker shall preserve the books of account and other records maintained under regulation 15 for a minimum period of **eight years**.

The broker also has to keep copies of KYC forms, agreement with clients, as part of his records. Stock brokers shall also maintain separate ledgers reflecting the customers' transactions which shall include, chronological and customer-wise record of money received and paid, chronological and customer-wise record of securities received and delivered specifically, chronological record of transactions made in a consolidated customers' account and record of the customer account information.

Every member broker shall keep such books of accounts, as will be necessary, to show and distinguish in connection with his business as a member:

a. Moneys received from or on account of each of his clients and
b. The moneys received and the moneys paid on Member's own account

Brokers need to maintain proper records of client collateral and to prevent misuse of client collateral. Brokers should have adequate systems and procedures in place to ensure that client collateral is not used for any purposes other than meeting the respective client's margin requirements / pay-ins. Brokers should also maintain records to ensure proper audit trail of use of client collateral.

### 3.4.5 Information Technology (IT)

Any stock broking office needs to have a complete integrated system that optimizes current business processes and provides a single integrated solution that covers all the aspects of the stock brokering industry. The system should be a fully integrated digital ecosystem

designed to manage back-office operations, real-time order execution, and risk control. This system must unify customer accounting, portfolio management, and automated trade functions within an archiving and auditing framework. Technical resilience is critical, requiring robust disaster recovery protocols and standby databases to prevent data loss or downtime. To ensure market integrity, SEBI mandates comprehensive software testing, including UAT and mock trading in exchange environments. All test reports must be verified and certified by independent system auditors before any software is released to the market. Brokers are also advised to implement software escrow arrangements to ensure business continuity in case a vendor fails to provide services. Large-scale brokers should consider engaging multiple vendors to reduce dependency and mitigate the impact of single-point failures. Service agreements must grant brokers access to design documents and ensure that staff are fully trained in software maintenance and usage

SEBI has mandated periodic system audit to members based on the category of stock brokers (broker using Exchange system, Broker using CTCL/DMA, Broker using Algorithmic trading etc.). The system audit mainly covers system controls and capabilities, risk management system, password security, network integrity, access control, back-up recovery, database security, software change management etc. SEBI vide circular dated January 31, 2025, introduced technology-based mechanism to monitor and supervise the way in which the system audits are conducted. [47]

The stock brokers desirous of outsourcing their activities shall not, however, outsource their core business activities and compliance functions. An example of core business activity may be execution of orders and monitoring of trading activities of clients in case of stock brokers.

#### 3.4.5.1 Business Continuity Plan (BCP) / Disaster Recovery (DR) Management

It is desirable that all stock brokers have business continuity plans. Ideally, the broker must create and maintain a written business continuity plan (BCP) identifying procedures relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the broker to meet its existing obligations to customers. In addition, such procedures must address the member's existing relationships with other broker-dealers and counter-parties. Stock brokers with a minimum client base across the exchanges, as may be specified by stock exchanges from time to time, shall mandatorily establish business continuity/DR set up. Stockbrokers shall put in place a comprehensive BCP-DR policy document outlining the standard operating procedures to be followed in the event of a disaster. A suitable framework shall be established to constantly monitor health and performance of critical systems during the normal course of business. The BCP-DR policy

[47] Vide SEBI Circular no.: SEBI/HO/MIRSD/TPD/CIR/2025/10 dated January 31, 2025 on Framework for Monitoring and Supervision of System Audit of Stock Brokers (SBs) through Technology based Measures.

document shall be periodically reviewed and updated to minimize incidents affecting the business continuity

### 3.4.5.2 Handling of Technical Glitches

With increasing dependence on technology in securities market, there is a rise in instances of glitches in trading members' systems, some of which lead to disruption of trading services and investor complaints. To address this issue, SEBI has taken various measures as given below:

SEBI has provided guideline for Investor Risk Reduction Access (IRRA) platform in case of disruption of trading services provided by the Trading Member[48].

Stock Exchanges have introduced the IRRA platform for their trading members. The salient features of this arrangement are given below:

- IRRA platform is available to the TMs supporting Internet Based Trading (IBT) and Security Trading through Wireless Technology (STWT) for their investors. IRRA is not be available for Algo trading and Institutional clients.

Once the affected TM requests or qualifies for invocation of IRRA, the platform will complete the invocation process, and send SMS and email notifications to all the Unique Client Codes (UCCs) of that Trading Member. These notifications inform investors that the IRRA platform is available for exiting or squaring off their open positions.

- The SMS communication will include a link to download the IRRA mobile application and a URL to access web-based trading platform, allowing investors to log in.
- Investors can login using their UCC or PAN, along with the OTP sent to their registered mobile number and email ID.
- The IRRA platform facilitates squaring off open positions and cancelling pending orders. Fresh positions or new orders cannot be placed through the platform. Additionally, positions built in securities or contracts permitted to settle only on a gross basis shall not be available for square off.
- Trading Members/Clearing Members remain responsible for all their clients' activities on the IRRA platform, including clearing & settlement and margin obligations.

**Business Continuity for Interoperable Segments of Stock Exchanges[49]**

[48]https://www.sebi.gov.in/legal/circulars/dec-2022/introduction-of-investor-risk-reduction-access-irra-platform-in-case-of-disruption-of-trading-services-provided-by-the-trading-member-tm-_66785.html
[49]https://www.sebi.gov.in/legal/circulars/nov-2024/business-continuity-for-interoperable-segments-of-stock-exchanges_89032.html

SEBI has mandated that NSE and BSE serve as alternative trading venues for each other during technical outages. For common products, positions can be offset on the functioning exchange, while for exclusive scrips, exchanges are required to create reserve contracts or new correlated products for hedging purposes. An affected exchange must notify SEBI and the alternative venue within 75 minutes of an outage, and the backup exchange must activate its business continuity plan within 15 minutes of such intimation. Participant can refer to the relevant SEBI circular for more details.

SEBI vide circular dated January 09, 2023, provided guideline on "Standard Operating Procedure for handling of Stock Exchange Outage and extension of trading hours thereof". The circular provides a Standard Operating Procedure regarding the handling of such stock exchange outages in Cash Market and Equity Derivatives segment. It provides details on the following:

- Definition of a Stock Exchange outage
- Reporting Requirements for such outage
- Trading on unaffected segment(s) / exchanges and the resumption of trading on the affected stock exchange
- Extension of trading hours in the event of an outage
- Updation of BCP document of MII

Framework to address the 'technical glitches' in Stock Brokers' Electronic Trading Systems[50].

**Salient features of the SEBI circular are given below**.

- A "Technical glitch" shall mean any malfunction in the electronic system of a stock broker, including malfunction in hardware, software, networks/bandwidth, processes or products or services, directly or indirectly related to trading and risk management, occurring during a stock exchange trading session. This includes malfunction in systems owned by stock brokers or those outsourced from third parties that lead to the stoppage, slowdown or variance in trading and risk management functions- such as log-in, order placement (including modification, cancellation, execution, confirmation, status), and the allocation or viewing of margin/ collateral/ funds etc., for a contiguous period of five minutes or more." SEBI has also specified certain types of technical issues will not be considered as technical glitches.
- Financial disincentive structure of stock exchanges shall not be applied to technical glitches that do not affect the stock broker's ability to provide seamless services to their clients.

[50] https://www.sebi.gov.in/legal/circulars/jan-2026/review-of-framework-to-address-the-technical-glitches-in-stock-brokers-electronic-trading-systems_99006.html

- The framework applies to stock brokers providing IBT/STWT trading having more than 10,000 registered clients (excluding closed accounts) as on 31st March of previous financial year.
- Stock brokers shall inform the stock exchanges and their clients regarding a technical glitch within 2 hours from the time of the glitch's.
- Stock brokers shall submit a Preliminary Incident Report to the Exchange within T+1 day of the incident (T being the date of the incident).
- Stock brokers shall submit a Root Cause Analysis (RCA) Report (as per format specified by SEBI) of the technical glitch to stock exchange, within 14 days from the date of the incident.
- Increasing number of investors may create additional burden on the trading system of the stock broker and hence, adequate capacity planning is prerequisite for stock brokers to provide continuity of services to their clients.
- Proactively and independently monitoring technical glitches shall be one of the approaches in mitigating the impact of such glitches. In this context, the stock exchange has advised to build API based Logging and Monitoring Mechanism (LAMA) to be operated between stock exchanges and specified stock brokers' trading systems. Under this mechanism, specified stock brokers shall monitor key systems & functional parameters to ensure that their trading systems function in a smooth manner.

  Candidates are requested to refer SEBI circular for additional details.

#### 3.4.5.3 Cyber Security & Cyber Resilience Framework (CSCRF) for Stock Brokers / Depository Participants[51]

To address evolving technological risks, SEBI introduced the Cyber Security and Cyber Resilience Framework (CSCRF), effective in phases from January 1, 2025. This framework mandates that stockbrokers, depositories, and other regulated entities establish robust measures to protect data integrity and privacy. The CSCRF supersedes all previous SEBI cybersecurity guidelines to provide a unified, modern standard for the Indian securities market. Its core objective is to improve Cyber Resilience, defined as an organization's ability to anticipate, withstand and recover from cyber-attacks.

The framework is built upon five primary resiliency goals: Anticipate, Withstand, Contain, Recover, and Evolve. These goals are strategically linked to six core functions: Governance, Identification, Protection, Detection, Response, and Recovery. A key requirement is the

[51] SEBI Circular No.: SEBI/HO/ITD-1/ITD_CSC_EXT/P/CIR/2024/113 dated August 20, 2024, on Cybersecurity and Cyber Resilience Framework (CSCRF) for SEBI Regulated Entities (REs).
https://www.sebi.gov.in/legal/circulars/aug-2025/technical-clarifications-to-cybersecurity-and-cyber-resilience-framework-cscrf-for-sebi-regulated-entities-res-_96329.html;
https://www.sebi.gov.in/legal/circulars/apr-2025/clarifications-to-cybersecurity-and-cyber-resilience-framework-cscrf-for-sebi-regulated-entities-res-_93734.html

establishment of a Security Operation Centre (SOC) for continuous monitoring of security events. Entities may manage their own SOC, utilize a group-level facility, or engage a third-party managed service provider. Recognizing that smaller entities may face expertise and cost barriers, SEBI has introduced the concept of a Market SOC (M-SOC)**.** Specifically**,** NSE and BSE are mandated to set up these Market SOCs to provide affordable cybersecurity solutions to smaller firms. This centralized approach ensures that even minor participants maintain a high level of defense against anomalous activities.

The framework emphasizes "informed preparedness" to anticipate adversary attacks before they cause significant disruption. It also focuses on "localization," ensuring that a crisis in one area is isolated to allow trusted business functions to continue. The "Evolve" goal pushes entities to continuously upgrade their cyber capabilities based on actual or predicted threat patterns. By mandating these standards, SEBI aims to foster a transparent and secure trading environment for all stakeholders. Compliance with the CSCRF is non-negotiable, as it covers systemically critical functions of the entire securities market.[52]

The CSCRF follows a graded approach and classifies Regulated Entities(Res) into five categories based on their span of operations and specific thresholds such as the number of clients, trade volume, asset under management, etc.

Below table classifies the REs in five categories:

i. Market Infrastructure Institutions (MIIs)
ii. Qualified REs
iii. Mid-size REs
iv. Small-size REs
v. Self-certification REs

| **Sr. No.** | **Parameters** | **Qualified REs** | **Mid Size REs** | **Small Size REs** | **Self-Certification REs** |
|---|---|---|---|---|---|
| 1 | Number of total registered clients | More than 10 lakhs | More than 1 lakh and up to 10 lakhs | More than 10,000 and up to 1 lakh | More than 1,000 and up to 10,000 |

[52] Participant can refer to the SEBI circular for further details: https://www.sebi.gov.in/legal/circulars/apr-2025/clarifications-to-cybersecurity-and-cyber-resilience-framework-cscrf-for-sebi-regulated-entities-res-_93734.html

| Sr. No. | Parameters | Qualified REs | Mid Size REs | Small Size REs | Self-Certification REs |
|---|---|---|---|---|---|
| 2 | Clientele trading volume in a year (in Crores) | More than 10, 00,000 | More than 1,00,000 and up to 10,00,000 | More than 10,000 and up to 1,00,000 | More than 1,000 and up to 10,000 |

Stock Brokers with less than 1,000 crores clientele trading volume (in a year) and less than 1,000 total registered clients are exempted from CSCRF.

As per SEBI's directive, all Members shall maintain a Standard Operating Procedure (SOP) for handling Cyber Security incidents. Stock Exchanges have advised members to prepare SOP addressing the handling and reporting of such Cyber Security incidents.

**3.4.5.4 Safeguards to avoid trading disruption in case of failure of software vendor**

Software vendors who provide software to market participants and market infrastructure institutions for the purpose of trading, risk management, clearing and settlement play a crucial role in the securities market. Any inability on the part of such software vendors to provide software or related services in timely and continuous manner may create a situation of stress in the securities market.

It was recommended that adequate mechanism/ procedure should be in place to ensure smooth transition by stock broker(s) to another software vendor in case of inability of the existing software vendor to provide software and related services in timely and continuous manner. Stock brokers have advised to take the following measures:

a) Explore the possibility of establishing a 'software escrow arrangement' with existing software vendors.

b) In case of large stock brokers, reducing dependence on a single software vendor for trading and risk management systems, by engaging more than one software vendor may be considered.

c) Broker can include the additional points as specified by regulators in contracts/agreements with the software vendors.

**3.4.5.5 Framework for Adoption of Cloud Services by SEBI Regulated Entities (REs)**

SEBI vide its circular SEBI/HO/ITD/ITD_VAPT/P/CIR/2023/033 dated March 06, 2023, provided "Framework for Adoption of Cloud Services by SEBI Regulated Entities (REs)". The major purpose of this framework is to highlight the key risks, and mandatory control measures which REs need to put in place before adopting cloud computing. The

document also sets out the regulatory and legal compliances by REs if they adopt such solutions. This cloud framework is applicable for adoption of public cloud and community cloud. Consequently, REs are permitted to deploy public cloud and community cloud models, subject to the conditions specified in above circular. A private cloud shall be considered as an on-premise deployment model and consequently, private cloud deployments shall be governed by SEBI circulars (for example cyber security circular, outsourcing circular, BCP-DR, etc.), guidelines, advisories, etc. issued from time to time. Therefore, private cloud deployments by REs) are permitted, however, such deployments may not be governed by this cloud framework. A hybrid cloud is a combination of two or more out of public cloud, community cloud and private cloud. Therefore, this cloud framework as well as the relevant SEBI circulars/ guidelines/ advisories shall be applicable for hybrid cloud deployments. In view of the above, hybrid cloud deployment is permitted, subject to the conditions specified in the above SEBI circular Deployment of any other cloud model is prohibited unless explicitly permitted under this framework. SEBI may allow deployment of other models after due consultations. The same may be specified by SEBI from time to time.
The cloud framework is a principle-based framework which covers Governance, Risk and Compliance (GRC), selection of Cloud Service Providers (CSPs), data ownership and data localization, due-diligence by REs, security controls, legal and regulatory obligations, DR & BCP, and vendor lock-in risk. The principles are broadly stated guidelines to set the standards by which RE must comply with while adopting cloud services.

W.r.t. to the 'Framework for Adoption of Cloud Services by SEBI Regulated Entities (REs)'issued vide SEBI circular SEBI/HO/ITD/ITD_VAPT/P/CIR/2023/033 dated March 06, 2023 (CSCRF: Annexure-J), implementation of a dedicated Hardware Security Module (HSM) shall be made mandatory for MIIs and Qualified REs (as per the classification given in CSCRF). However, mid-size REs, small-size REs, and self-certification REs shall be allowed to implement any alternative of HSM based on their risk assessment. Such risk assessment shall be approved by the Board/ Partners/ Proprietor of the REs.

**3.4.6 Securities Transaction Tax**

Securities Transaction Tax (STT) is levied on every purchase or sale of securities that are listed on the Indian Stock Exchanges. This includes shares, derivatives or equity-oriented mutual funds units. STT is collected by the broker from their client and remitted to the Stock Exchanges /Clearing Corporations.

The following STT rates are applicable for trades executed in the Equity segment of the Stock Exchange:

| Sr. No. | Taxable securities transaction | Current Effective Rates | Payable by |
|---|---|---|---|
| 1. | Purchase of an equity share in a company or a unit of a business trust, where-<br>(a) the transaction of such purchase is entered into in a recognized stock exchange and<br>(b) the contract for the purchase of such share or unit is settled by the actual delivery or transfer of such share/ unit. | 0.100 per cent | Purchaser |
| 2. | Sale of an equity share in a company or a unit of a business trust, where-<br>(a) the transaction of such sale is entered into in recognized stock exchange and<br>(b) the contract for the sale of such share or unit is settled by the actual delivery or transfer of such share or unit. | 0.100 per cent | Seller |
| 2A | Sale of a unit of an equity-oriented fund, where- (a) the transaction of such sale is entered into in recognized stock exchange and<br>(b) the contract for such unit is settled by the actual delivery or transfer of such share or unit | 0.001 per cent | Seller |
| 3 | Sale of an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, where-<br>(a) the transaction of such sale is entered into in a recognized stock exchange and such<br>(b) the contract for the sale of such share or unit is settled otherwise than by the actual delivery or transfer of such share or unit . | 0.025 per cent | Seller |

The following rates are applicable for transactions executed in the Equity Derivatives Segment:[53]

| Sr. No. | Taxable securities transaction | Current Effective Rates | Payable by |
|---|---|---|---|
| 1 | Option in equity securities & equity Indices | 0.100 per cent on premium | Seller of an option |
| 2 | Option in equity securities & equity indices, where option is exercised | 0.125 per cent on intrinsic value | Buyer of an option |
| 3 | Sale of a futures in equity securities & equity indices | 0.020 per cent | Seller |

[53] Subject to change with effect from April 01, 2026.

STT rate applicable to the delivery-based transaction (@0.1% by both receiver as well as giver of securities) shall also be applicable on the physical settled stock derivatives (both futures and options). STT is not applicable on Currency Derivatives, Interest Rate Derivatives and Debt Securities transactions.

Stock Exchanges/Clearing Corporation provide a report to the brokers/members at the end of each trading day. The report contains information on the total STT liability, trading member wise STT liability, client wise STT liability and also the detailed computations for determining the client wise STT liability

**Exchange Transaction Charges**

Exchange transaction charges are fees levied by stock exchanges on every trade executed on their platforms. These charges are collected by brokers from their clients and then passed on to the exchanges. Generally, transaction charges are collected by SEs on monthly basis. In July 2024[54], SEBI mandated market infrastructure institutions (MIIs) to use uniform transaction charges, eliminating previous volume-based slab discounts for brokers to increase transparency for end investors.

### 3.4.7 Stamp Duty with respect to securities market instrument[55]

In order to facilitate ease of doing business and to bring in uniformity of the stamp duty on securities across States and thereby build a pan-India securities market, the Central Government, through requisite amendments in the Indian Stamp Act, 1899 and Rules made thereunder, has created the legal and institutional mechanism to enable states to collect stamp duty on securities market instruments at one place by one agency (through Stock Exchange or Clearing Corporation authorized by it or by the Depository) on one Instrument. A mechanism for appropriately sharing the stamp duty with relevant State Governments has also been developed which is based on the state of domicile of the buyer.

The relevant provisions of the Finance Act, 2019 amending the Indian Stamp Act, 1899 and the Indian Stamp (Collection of Stamp-Duty through Stock Exchanges, Clearing Corporations and Depositories) Rules, 2019 were notified simultaneously. The Amendments in the Indian Stamp Act, 1899 brought through Finance Act 2019 and Rules made thereunder came into effect from July 01, 2020. Mechanism similar to STT has been implemented by Exchange/Clearing Corporation for determination and collection of stamp duty from

[54]https://www.sebi.gov.in/legal/circulars/jul-2024/charges-levied-by-market-infrastructure-institutions-true-to-label_84506.html

[55]https://upload.indiacode.nic.in/showfile?actid=AC_CEN_2_2_00036_189902_1523339055436&type=rule&filename=stamp_act,_2019.pdf and http://egazette.nic.in/WriteReadData/2019/214585.pdf

brokers. Brokers have to collect the stamp duty from their clients and remit to Exchange/Clearing Corporation.

### 3.4.8 SEBI Turnover [56]Fees

SEBI turnover fees are a regulatory charges levied on all securities transactions to fund the regulator's operations. These fees are collected by brokers from clients and remitted to the stock exchanges, which then transfer them to SEBI on monthly basis
The fee structure is as follow:

- The fee is 0.0001% of the transaction value, which amounts to Rs.10 per Rs.1 crore of turnover. This applies to equities, equity derivatives (futures and options), and currency derivatives.
- A fee of Rs.5 per Rs.1 crore of turnover applicable to Interest Rate Derivatives and

A fee of Rs.2 per Rs.1 crore of turnover is applicable in Debt Segment.

### 3.4.9 Bulk Deals & Block Deals

**Bulk Deals**

With a view to imparting transparency in bulk deals and to prevent rumors/speculation about such deals causing volatility in the scrip price, it was decided by SEBI to bring about greater disclosure of such bulk deals as mentioned below: [57]

- The disclosure shall be made with respect to all transactions in a scrip where total quantity of shares bought/sold is more than 0.5% of the number of equity shares of the company listed on the stock exchange. The quantitative limit of 0.5% can be reached through one or more transaction executed during the day in the normal market segment.
- The brokers shall disclose to the Stock Exchange the name of the scrip, name of the client, quantity of shares bought/sold and the traded price.
- The disclosure shall be made by the brokers immediately upon execution of the trade. In case of Bulk Deals:
    - Single Trade: Immediately upon the execution of the order where the traded quantity either buy or sell on account of any trade (client / proprietor) is more than 0.5% of the number of equity shares of the company listed on the stock exchange.

[56] The expression 'turnover' shall include the value of the trades executed by the stock broker on the concerned segment of the recognized stock exchange and of the trades settled on the expiration of the contracts

[57] Vide SEBI Circular SEBI/MRD/SE/Cir-7/2004) dated January 14, 2004

- Cumulative Trades for the Day: Within one hour from the closure of the trading hours, the quantity traded on that day either purchases or sale under proprietary or any single client code is more than 0.5% of the number of equity shares of the company listed on the stock exchange

The Stock Exchanges shall disseminate the aforesaid information on the same day after market hours to the general public.

**Block Deals (Block Trading Session)**

In September 2005, SEBI permitted the Stock Exchanges to set up a separate trading window called block window.[58] SEBI vide circular dated October 08, 2025, revised the block deal framework[59]. This window allows large size trades to be executed as a single transaction without putting the buyer or seller at a disadvantageous position. A trade, with a minimum value of Rs.25 crore executed through a single transaction on this separate window of the stock Exchange constitutes a **"block deal"** as distinguished from "bulk" deal.

"Block Deals" are subject to the following conditions:

- 'Block Deal' windows is available twice a day under the names "Morning Block Deal Window" and "Afternoon Block Deal Window". The morning block deal window operates between 8.45 a.m. to 9.00 a.m. and the afternoon window operates between 2.05 p.m. to 2.20 p.m.
- The reference price for execution of block deals in the Morning Window shall be the previous day closing price or adjusted close price/base price of the stock. The stock exchanges shall set their trading hours between 8.45 a.m. to 9.00 a.m. with a stipulation that between this time, the stock exchanges shall operate only for executing trades in the block deal window.
- The reference price for execution of block deals in the afternoon window shall be the volume weighted average market price (VWAP) of the trades executed in the stock in the cash segment between 01.45 p.m. to 02.00 p.m. Between the period 02.00 p.m. to 02.05 p.m., the stock exchanges shall calculate and disseminate necessary information regarding the VWAP applicable for the execution of block deals in this window. In case no trades are executed in the security in the cash segment between 01:45 PM to 02:00 PM, the reference price shall be considered as follows:

[58]Vide SEBI circular number: MRD/DoP/SE/Cir- 19 /05 dated September 2, 2005
[59] https://www.sebi.gov.in/legal/circulars/oct-2025/review-of-block-deal-framework_97145.html

- VWAP based on trades executed in the security between 9:00 am to 1:45 pm shall be taken as reference price. For the computation of VWAP, the trades of pre-open / special pre-open session, shall also be considered.
- In case VWAP not available as per above, then previous day close price or adjusted close price / base price of stock

- The orders may be placed in this window at a price not exceeding ±3% of the applicable reference price in the respective block deal window.
- An order may be placed for a minimum value of Rs.25 crore.
- Every trade executed in this window must result in delivery and shall not be squared off or reversed.
- The broker shall make disclosure of the block deal to the Exchanges with client information. The stock Exchanges shall disseminate the information on block deals such as the name of the scrip, name of the client, quantity of shares bought/sold, traded price, etc. to the general public on the same day, after the market hours.
- The applicability of all other trading and settlement related practices as well as surveillance and risk containment measures shall be ensured by the stock exchanges.
- The above provisions shall also be applicable for the block deal window under the optional T+0 settlement cycle.

### 3.4.10 Other Trading Session in Equity Segment

**Pre-open session (Regular)**

- The pre-open session in the Indian equity segment primarily serves to minimize market volatility at the start of the day and to facilitate an efficient price discovery mechanism based on overnight news and global market cues. This process helps in determining a fair opening price for stocks before the normal trading session begins.

The session lasts for 15 minutes from 9:00 am to 9:15 am.

- The pre-open session is comprised of two distinct phases: the order collection period and the order matching & trade confirmation period
- Order entry for first 8 minutes with random closure in last 1 minute
- All equity and SME securities are eligible for the pre-open session.
- Price discovery is conducted through call auction mechanism
- Equilibrium price based on the demand-supply.

**Normal session**

- Main trading session of cash market
- Duration from 9:15 am to 3:30 pm

- Continuous order matching strictly on price-time priority

**Auction Market**

- The auction market generally opens at 2:00 pm/2:30pm onwards
- Buying-in auction conducted for short deliveries
- Exchange initiate the buy auction on behalf of clearing corporation
- Participation in auctions by participant by entering orders as a solicitor
- The solicitor period is 30 minutes from the time it is initiated.
- Matching initiated at end of solicitor period

**Post close market**

- Trading session after normal market hours
- Market timing 3:40 pm to 4:00 pm
- Only market orders are allowed
- Single price matching based on close price

**Call auction for illiquid securities**

- Periodic call auction for illiquid securities
- 6 sessions of one hour from 9:30 am to 3:30 pm
- Session is comprised of order collection period and order matching & trade confirmation period
- The first 45 minutes of the session (e.g., 9:30 AM - 10:15 AM) are for placing, modifying, or cancelling orders. This period closes randomly between the 44th and 45th minute to prevent last-minute manipulation.
- Price discovery through call auction mechanism
- Equilibrium price based on demand-supply

**Special Pre-open session**

- Applicable for IPO and other securities specified by SEBI from time to time
- Duration of 60 minutes i.e., from 9:00 am to 10:00 am
- The pre-open session is comprised of order collection and order matching & trade confirmation period
- Order entry for first 45 minutes with random closure in last 10 minutes
- Price discovery through call auction mechanism
- Equilibrium price based on demand-supply

**Trade for Trade Segment**

- Each trades are settled separately.
- No netting of transaction
- Mainly securities moved to TFT due to surveillance action

- Margin of 100%
- Price band mainly 2% / 5%

**Small & Medium Enterprises (SME) Platform**

- The SME trading platform is available on the cash market segment of Exchanges
- SME securities are distinctly identified on trading system
- Alternate options are available for trading of the securities of the listed companies. The SME securities can trade either in the normal (continuous) market or have daily liquidity window through a call auction session.
- Market making is mandatory for 3 years for SME securities. Separate trader workstation is provided for market maker.
- Market maker quotes or transactions will be identified distinctly. Market maker has to provide two-way quotes within certain bid-ask spread for specific time period and for certain minimum quantity.
- The trading system will have hybrid features which will allow quotes by market makers in an order driven system.
- Market lot of Rs.1 lakh and in multiple of Rs.1 lakh (Lot size in quantity based on the share price)

**Offer for Sale (OFS) through Stock Exchanges**

- Seller: eligibility criteria for seller to conduct OFS through secondary market mechanism
- Buyer: All investors registered with the brokers other than the promoter(s) or promoter group entities shall be eligible to buy shares under OFS. In case the offer is by non-promoter shareholder, the promoter(s) or promoter group entities may participate in the OFS.
- Announcement of offer on T-1 day, where T day on which bidding will start.
- Timelines: T day non-retail investor will enter the bid. Retail investor will bid on T+1 day
- Orders with 100% of margin paid upfront by institutional investors and non-institutional investors. Such orders can be modified or cancelled at any time during the trading hours. Orders without paying upfront margin by institutional investors only. Such orders cannot be modified or cancelled by the investors or stock brokers, except for making upward revision in the price or quantity.
- Settlement through clearing corporation
- In case of default in pay-in by any investor, 10% of the order value shall be charged as penalty

- Settlement Guarantee Fund shall not be available for OFS through stock exchange mechanism.
- The brokers shall be required to issue contract note to the client based on the allotment price and quantity in terms of conditions specified by the exchange.

**Trading Session Time Line for T+1 Settlement**

| Trading Session | Timings |
|---|---|
| Morning Block Window | 8:45 am to 9:00 am |
| Pre-open Session | 9:00 am to 9:15 am |
| Normal Session | 9:15 am to 3:30 pm |
| Afternoon Block Window | 2:05 pm to 2:20 pm |
| Post Close Session | 3:40 pm to 4:00 pm |
| Call Auction Session for Illiquid Securities | 9:30 am to 3:30 pm |
| Pre-open Session for IPO and Re-listed Securities | 9:00 am to 10:00 pm |

### 3.4.11 Securities Lending and Borrowing Segment (SLBS)

The Securities Lending and Borrowing (SLB) mechanism in the Indian equity market, regulated by SEBI, allows investors to lend their idle shares for a fee and traders to borrow them for various strategies like short selling or arbitrage. SLB involves the temporary transfer of securities from a lender to a borrower for a fixed period in exchange for a lending fee. The SEBI has provided regulatory guidelines for trading in SLBS.

**Securities Lending and Borrowing Scheme (SLBS) – Key Features**

| Parameter | Details |
|---|---|
| **Trading System** | Screen-based, anonymous order matching platform |
| **Eligible Securities** | F&O securities, eligible non-F&O stocks, and Exchange Traded Funds (ETFs) |
| **Contract Tenure** | Monthly contracts up to **12 months** with second/reverse leg settlement on the **1st Thursday** of the respective series month |
| **Price Quotation Basis** | Lending fee quoted **per share** |
| **Eligible Investors** | Retail investors, Proprietary traders, and Institutional investors |
| **Access Mechanism** | Borrowers and lenders access the SLBS platform through **Approved Intermediaries (AIs)** via **Clearing Members (CMs)**, including banks and custodians, authorized by the Clearing Corporations |
| **Corporate Benefits** | Corporate actions and benefits remain with the **lender (actual owner of securities)** |

| Parameter | Details |
|---|---|
| **Clearing & Settlement Process** | Settlement carried out through the **Clearing Corporation**. In the first leg, lender delivers securities and borrower pays lending fee; in the reverse leg, borrower returns securities to the lender |
| **Settlement Guarantee & Risk Management** | Clearing Corporation provides settlement guarantee supported by **initial margin** and **daily mark-to-market (MTM)** adjustments |
| **Position Limits** | Security-wise position limits applicable |

### 3.4.12 Regulatory Compliances

The stock broker has to follow certain regulatory compliances under the law, rules, regulations and bye laws of SEBI and the Exchanges. These are mandatory and non-compliance to these rules, regulations, circulars, laws attracts penal action. However, the main compliances include:

- Maintain or furnish documents as prescribed under the various sub-sections of section 15 of SEBI Act;
- Maintenance of different types of Books as prescribed under SC(R)R 1957, SEBI Stock Broker regulation, 2026 (e.g. Sauda book etc.);
- Compliance related to use of terminal, office management etc.;
- Compliance related to dealing with other intermediaries including Authorized Person;
- Compliance related to dealing with clients;
- Sending account statements to clients;
- Submission of various periodic reports to the stock Exchanges etc.

These are covered in detail in section 4.2 under Regulatory Compliances and Reporting.

**Chapter 3**: **Sample Questions**

1. Direct Market Access facility is mainly introduced for _____.
   a. Retail Investors.
   **b. Institutional Clients.**
   c. Specific International Broking Firms.

2. Which of the following statement is false ?
   a. On receipt of the order at the Exchange system, an order confirmation is sent to the broker.
   b. Depending upon the order terms and conditions and the actual prevailing market prices, the order may get executed immediately, partially or fully.
   **c. The order can be entered for buy or sell irrespective of whether the client has sufficient balance of funds or securities in his account.**

2. A contract note is _____.
   a. A legal document which is entered upon by the client with his broker before entering into any transaction.
   **b. Confirmation of trade done during the particular day with all details of which securities have been bought or sold, at price etc.**
   c. A note which holds margin details.

3. Maintenance of different types of Books by stock brokers is prescribed under _____.
   **a. SC(R)R 1957**
   b. SCRA 1956
   c. SEBI Intermediaries Regulations
   d. Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018

4. Members should obtain prior approval for all advertisement before issuance from _____.

   **a. Stock Exchanges**

   b. SEBI

   c. Depositories

5. The SEBI turnover fee of _____ per INR 1 crore of turnover is applies to Interest Rate Derivatives segment.

   a. Rs. 1

   b. Rs. 2

   c. **Rs. 5**

6. For initial period of 3-years market making is mandatory in _____ segment.

   a. **SME**

   b. Interest Rate Derivatives

   c. Index Futures & options

7. Regular pre-open session in equity segment start at _____.

   a. 8:45 am

   b. **9:00 am**

   c. 9:15 am

8. Investor Risk Reduction Access (IRRA) platform is provided by _____.

   a. **Stock Exchanges**

   b. SEBI

   c. Clearing Corporation

9. Statutory levies will include _____.

   a. Exchange transaction charges

   b. SEBI turnover fees

   c. **Security Transaction Tax**

# CHAPTER 4: RISK MANAGEMENT

**LEARNING OBJECTIVES:**

**After studying this chapter, you should know about:**

- Risk management framework for capital market and derivatives segment
- Compliances and Regulatory Reporting by the Stock Brokers
- Core Settlement Guarantee Fund

## 4.1 Risk Management

### 4.1.1 Risk Management Framework for Capital Market / Equity Segment

A comprehensive Risk Management framework is the backbone of the Clearing Agency/Corporation/house. A clearing corporation/house provides settlement guarantee i.e., the settlement of securities and funds will take place even if there is a failure by a broker/clearing member to fulfill their obligation. In order to safeguard against such failures, the clearing agency is required to carry out the risk management measures as specified by SEBI through its various circulars.

The risk management system should be well documented and made accessible to clients as well as the Exchange / Clearing Corporation. As in derivatives segment, the TMs/CMs in cash segment are required to mandatorily collect upfront Value at Risk (VaR) margins and Extreme Loss Margin (ELM) from their clients.[60].While other margins (MTM, delivery, special) must be paid upon call, brokers are granted until settlement day to collect them for the purpose of penalty calculation.. This window is provided to account for practical difficulties and should not be construed as an entitlement for clients to delay payment. If a client completes the full pay-in of funds and securities by the settlement day, all other margins are deemed collected. [61].. However, failure to complete pay-in or collect necessary margins by this deadline results in penalties. Brokers are exempt from collecting MTM if initial margins sufficiently cover potential losses, and they avoid short-collection penalties if a minimum 20% upfront margin is collected in lieu of VaR and ELM. Actual / short-collections/ non-collection margins must be reported to the Exchange on a T+5 basis.
Clearing Corporations, Risk containment measures include capital adequacy requirements of members, monitoring of member performance and track record, stringent margin

[60] Vide SEBI CIR/HO/MIRSD/DOP/CIR/P/2019/139 November 19, 2019 and SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020
[61] SEBI Circular No.: SEBI/HO/MIRSD/MIRSD-PoD/P/CIR/2025/57 dated 28 April,2025

requirements, position limits based on capital, online monitoring of member positions and automatic disablement from trading when limits are breached, etc.

Following are the salient features of Clearing Corporation Risk Management System which is applicable for Cash as well as Derivatives Segment:

- On-line real time risk management
    - Online monitoring of margin against liquid assets
    - On-line position limit monitoring
- Scientific way of identifying margin level
- Different kind of margins to cover all kind of losses
- Intra-day and end of day mark to market
- Client level collateral segregation & margining
- Alert to member on various level of collateral utilization
- Risk reduction mode
- Automatic disablement from trading when limits are breached
- Cross margining facility
- Capital adequacy requirements of members
- Monitoring of member performance and track record

Risk Management framework consists of the following components:

- Margin
- Liquid Asset
- Base minimum capital
- Pre-trade risk control
- Risk Reduction mode

**4.1.1.1 Margin**

Margining is a process by which a clearing corporation computes the potential loss that can occur to the open positions (both buy and sell) held by the members across all its clients. Based on the computation, the clearing corporation will ensure that the liquid assets deposited by members is sufficient to cover the potential loss.

SEBI has, from time to time, put in place various risk containment measures to address the risks involved in the cash and derivatives market. The details of the same is given below:

In Cash/Equity Segment the clearing corporation computes and collects three kinds of margins namely:

- Value at Risk Margin (VaR) to cover potential losses for 99.9% of the days.
- Mark to Market (MTM) Loss Margin: Mark to market losses on outstanding settlement obligations of the member. (Also include intraday Crystallized MTM losses)

- Extreme loss margin: Margins to cover the loss in situations that lie outside the computation of the VaR margin.

The liquid asset of the member at all point of time should be adequate to cover all the above requirements.

**VaR Margin**

The VaR Margin is a margin intended to cover the largest loss that can be encountered on 99.9% of the days (99.9% Value at Risk). For margin purpose securities were classified in three groups based on the liquidity, impact cost namely; Liquid Securities, Less Liquid Securities and Illiquid Securities.

*Scrip sigma* means the volatility of the security computed as at the end of the previous trading day. The computation uses the exponentially weighted moving average method applied to daily returns of the stock prices in the same manner as in the derivatives market.

**Liquidity Categorization of Securities for the purpose of Margin**

The securities shall be classified into three groups based on their liquidity:

| **Group** | **Trading Frequency over the previous six months** | **Impact Cost** |
|---|---|---|
| Liquid Securities (Group I) | At least 80% of the days | Less than or equal to 1% |
| Less Liquid Securities (Group II) | At least 80% of the days | More than 1% |
| Illiquid Securities (Group III) | Less than 80%of the days | N/A |

All SME securities are classified as group III securities.

For securities that have been listed for less than six months, the trading frequency and the impact cost shall be computed using the entire trading history of the scrip.

The trading frequency and impact cost shall be calculated on the 15$^{th}$ of each month on a rolling basis considering the previous 6 months for impact cost and previous 6 months for trading frequency. On the basis of the trading frequency and impact cost so calculated, the securities shall move from one group to another group from the first of the next month.

For the first month, till the time of monthly review, a newly listed stock shall be categorized in that Group where the market capitalization of the newly listed stock exceeds or equals the market capitalization of 80 percent of the stocks in that particular group. Subsequently, after one month, whenever the next monthly review is carried out, the actual trading

frequency and impact cost of the security shall be computed, to determine the liquidity categorization of the security.

In case any corporate action results in a change in ISIN, then the securities bearing the new ISIN shall be treated as newly listed scrip for group categorization.

**Calculation of mean impact cost**

Mean impact cost represents the liquidity of a scrip and is calculated using a standardized methodology across exchanges. It measures the average percentage price movement caused by a hypothetical order of ₹1 lakh relative to the mean of the best bid and offer (the ideal price). Calculations are based on four random snapshots taken daily within fixed ten-minute windows over the previous six months, covering both the buy and sell sides. Exchanges are required to use a common methodology and must disseminate the results and any changes to the calculation on their websites.

**Table 4.1: VaR Margins for different group of stocks**

| Liquidity Categorization | VaR Margin Rate |
|---|---|
| Liquid Securities (Group I) | Based on 6σ, subject to minimum of 9% |
| Less Liquid Securities (Group II) | Based on 6σ, subject to minimum of 21.5% |
| Illiquid Securities (Group III) | 50% if traded at least once per week on any stock exchange; 75% otherwise |

**Note:**

- Index ETFs are based on a basket of securities. However, for computing margins on ETFs they are treated at par with stocks and margins that are applicable on stocks are being applied for ETFs. In order to bring efficiency, in case of ETFs that track broad based market indices and do not include ETFs which track sectoral indices, the VaR margin rate shall be 6 sigma(σ), subject to minimum of 6%.
- Group III the securities shall be monitored on a weekly basis, and the VaR -margin rates shall be increased to 75% if the security has not traded for a week. In case the VaR margin rate is 75% and the security trades during the day, the VaR margin rate shall be revised to 50% from start of next trading day.

**Collection of VaR margin**

- VaR margin is collected on an upfront basis by adjusting against the total liquid assets of the member at the time of trade.
- VaR margin is collected on the gross open position of the member. The gross open position for this purpose would mean the gross of all net positions across all the clients of a member including his proprietary position. For this purpose, there would be no netting of positions across different settlements. Please refer below example.

- The VaR margin so collected shall be released along with the pay-in, including early pay-in of securities.

Value in INR

| Client | Security | Settlement No. | Buy Value | Sell Value | Net Value |
|---|---|---|---|---|---|
| Client A | Security X | 2005001 | 1000 | 1100 | -100 |
| | Security Y | 2005002 | 3000 | 2550 | 450 |
| | | | | | |
| Client B | Security Z | 2005001 | 1500 | 1650 | -150 |
| | Security Y | 2005002 | 3000 | 1650 | 1350 |
| | | | | | |
| Client C | Security X | 2005001 | 4500 | 2400 | 2100 |
| | Security Z | 2005002 | 7000 | 10450 | -3450 |
| | | | | | |
| Proprietary Position | Security Y | 2005001 | 250 | 1200 | -950 |
| | Security Z | 2005002 | 1050 | 0 | 1050 |
| | | | | | |
| Member's Gross Position | | | | | |
| | Security X | 2005001 | | | 2200 |
| | Security Y | 2005001 | | | 950 |
| | Security Z | 2005001 | | | 150 |
| | Security X | 2005002 | | | 0 |
| | Security Y | 2005002 | | | 1800 |
| | Security Z | 2005002 | | | 4500 |

**VaR Margin Rate**

The applicable VaR margin rates shall be updated at least 5 times in a day, which may be carried out by taking the closing price of the previous day at the start of trading and the prices at 11:00 a.m., 12:30 p.m., 2:00 p.m. and at the end of the trading session.

**Extreme Loss Margin**

Extreme loss margin [62]covers the expected loss in situations that go beyond those envisaged in the value at risk estimates used in the VaR margin. The Extreme Loss Margin shall be 3.5% for any stock and 2% for ETFs that track broad based market indices and do not include ETFs which track sectoral indices. The Extreme Loss Margin shall be collected/ adjusted against the total liquid assets of the member on a real time basis. The Extreme Loss Margin shall be collected on the gross open position of the member. For this purpose, there would be no netting off of positions across different settlements. The Extreme Loss Margin collected shall be released on completion of pay-in of the settlement.

[62] The term Extreme Loss Margin replaces the terms "exposure limits" and "second line of defence"

**Margins for securities in Trade for Trade-Surveillance market (TFTS)**

Upfront margin rates (VaR Margin + Extreme Loss Margin) applicable for all securities in the TFTS shall be 100%.

**Mark to Market Losses**

Mark to market loss is calculated by marking each transaction in security to the closing price of the security at the end of trading. In case the security has not been traded on a particular day, the latest available closing price is considered as the closing price. In case the net outstanding position in any security is nil, the difference between the buy and sell values is considered as notional loss for the purpose of calculating the mark to market margin payable. MTM profits / losses would be computed for each of the clients Client A, Client B, Client C etc. As regards collection of margin from the broker, the MTM would be grossed across all the clients i.e. no setoff of loss of one client with the profit of another client. In other words, only the losses will be added to give the total MTM loss that the broker has to deposit with the exchange.

| | | MTM Profit Loss | | |
|---|---|---|---|---|
| | | Security Level | Client Level | Broker Level |
| Client A | Security X | 300 | | |
| | Security Y | -1200 | -900 | |
| | | | | |
| Client B | Security Z | -1300 | | |
| | Security Y | -200 | -1100 | |
| | | | | |
| Client C | Security A | 800 | | |
| | Security Y | 600 | 1400 | |
| | | | | |
| Broker | | | | -2000 |

**Mark to Market margin is collected in the following manner:**

- The clearing corporation collects mark to market margin (MTM) from the member/broker before the start of the trading of the next day.
- The MTM margin is collected or adjusted against the cash/cash equivalent component of the liquid assets of the member.
- The MTM margin is collected on the gross open position of the member. The gross open position means gross of all net positions across all the clients of a member including his proprietary position. For this purpose, the position of a client would be netted for each of its various securities and the positions of all the clients of a broker would be grossed.

- In case of security in Trade For Trade Surveillance market (TFTS), each trade shall be marked to market based on the closing price of that security.
- There would be no netting off of the positions and setoff against mark to market profits across two different settlements i.e. T+1 and T+0. However, for computation of mark to market profits/losses for the day, netting or setoff against mark to market profits would be permitted.
- The margin so collected shall be released along with the pay-in, including early pay-in of securities.

Clearing Corporation shall calculate and levy the Intraday Crystallized Mark to Market Losses (ICMTM) in the following manner**:**

- ICMTM shall be computed for all trades subject to upfront margining which are executed and closed out on the same trading day.
- ICMTM shall be calculated based on weighted average prices of trades
- ICMTM shall be adjusted against the liquid assets of the member on a real time basis.
- Crystallised losses at a security level for a client shall be adjusted against the crystallised profit, if any, from another security for the same client to arrive at client level profit or loss. However, there will be no setoff against crystallised profits across two rolling settlements.
- All client level losses including losses on proprietary positions if any shall be grossed up to arrive at member level ICMTM.
- ICMTM shall not be computed in case of security in TFTS.
- ICMTM shall be included in the end of day MTM computation.
- If crystallised losses exceed the free collateral available with the Clearing Corporation, then the entity shall be put into risk reduction mode.
- ICMTM so blocked/ collected shall be released on completion of pay-in of the settlement or early pay-in.

**Additional Margin on High Volatile Stocks**

i. For securities with intra-day price movement (maximum of [High-Low], [High-Previous Close], [Low-Previous Close]) of more than 10% in the underlying market for 3 or more days in last one month, the minimum total margins shall be equal to the maximum intra-day price movement of the security observed in the underlying market in last one month. The same shall be continued till monthly expiry date of derivative contracts which falls after completion of three months from date of levy.

ii. For securities with intra-day price movement (maximum of [High-Low], [High-Previous Close], [Low-Previous Close]) of more than 10% in the underlying market for 10 or more days in last six months, the minimum total margins shall be equal to the maximum intraday price movement of the security observed in the underlying

market in last six months. The same shall be continued till monthly expiry date of derivative contracts which falls after completion of one year from date of levy.

It is to be noted that the same additional margin is applicable for the F&O segment also.

**Margins not to exceed the purchase value of a buy transaction**

In case of a buy transaction in cash market, VaR margins, extreme loss margins and mark to market losses together shall not exceed the purchase value of the transaction. Further, in case of a sale transaction in cash market, VaR margins and extreme loss margins together shall not exceed the sale value of the transaction and mark to market losses shall also be levied.

#### 4.1.1.2 Liquid Assets

The core of the risk management system is the liquid assets deposited by members with the exchange/clearing corporation. These liquid assets shall cover the following four requirements namely; Mark to Market Losses, VaR Margins, Extreme Loss Margins, Base Minimum Capital.

The acceptable liquid assets and the applicable haircuts are listed in Table 4.2.

**Table 4.2: Acceptable Liquid assets along with haircuts and limits[63]**

| Item | Haircut | Limits |
|---|---|---|
| ***Cash Equivalents*** | | |
| Cash | 0 | No limit |
| Bank fixed deposits (FD) | 0 | Refer Note |
| Bank guarantees | 0 | Limit on Exchange's/Clearing Corporation exposure to a single bank (Refer Note) |
| Securities of the Central Government | Refer Note | No limit |
| Units of growth plans of overnight mutual fund scheme | 5 percent | No limit |
| Units of overnight mutual fund schemes (other than growth plans), liquid mutual fund schemes or government securities | 10 percent | No limit |

[63] https://www.sebi.gov.in/legal/master-circulars/dec-2024/master-circular-for-stock-exchanges-and-clearing-corporations_90353.html

| Item | Haircut | Limits |
|---|---|---|
| mutual fund schemes (by whatever name called which invest in government securities) | | |
| ***Other liquid assets (Non-Cash Component)***<br>1. Cannot be used for mark to market losses<br>2. Total of other liquid assets cannot exceed total of Cash Equivalents | | |
| Equity shares with impact cost of upto 0.1% for an order value of Rs. 1 lakh and traded for atleast 99% of days over the period of previous 6 months | VaR margin based on 6 sigma subject to minimum of 9%. | Limit on exposure to a single issuer. (Refer Note) |
| Units of Mutual fund schemes other than those listed under cash equivalents | VaR margin based on 6 sigma subject to minimum of 9%. | No limit |
| Corporate Bonds | Fixed percentage based or VaR based Haircut. A higher haircut may be considered to cover the expected time frame for liquidation. To begin with the haircut shall be a minimum of 10 percent. | Not to exceed 10 percent of the total liquid assets of the clearing member. (Refer Note) |

**Few details about liquid asset is provided below. For additional details participants are requested to refer SEBI master circular for stock exchanges and CC.**

A. The valuation of the liquid assets shall be done on a daily basis after applying applicable haircuts.

B. The exposure of CCs and its subsidiaries towards banks through Cash, FDs and BGs must be adequately diversified, and daily exposure to a single bank shall not exceed the percentage specified by the SEBI from time to time.

C. Mark to market losses shall be paid by the member in the form of cash or cash equivalents.

D. Cash equivalents shall be at least 50% of liquid assets. This would imply that Other Liquid Assets in excess of the total Cash Equivalents would not be regarded as part of Total Liquid Assets.

E. Exposure of CCs to equity and debt instruments (both bank and non-bank entities) through CMs may be subject to the exposure to single issuer.

F. CCs shall not accept collateral including FDs, BGs, equity, or debt securities issued by CMs/TMs themselves or their group or associate entities.

G. Haircut on securities of the Central Government will be based on liquidity and tenor of the security.
H. CCs exposure to the corporate bonds provided by a CM shall not exceed certain percentage of liquid asset based on the long term credit rating of the issuer
I. In case the equity security does not meet the liquid security criteria (as specified in the table above), the same needs to be replaced by the CM at the earliest.
J. CCs shall not accept the collaterals from CMs, which are acquired through bespoke transactions (i.e. the CM is the sole subscriber of such corporate debt issuances).
K. The overall daily exposure of a CC to a single bank (including cash, FD, BG, equity and debt) through CM collateral shall not exceed 20% of the total liquid assets.
L. Clearing Corporation generally provides list of approved securities and other collateral related information on monthly basis.

**Margining of Institutional Trades in Cash Market**

All Institutional trades in the cash market would be subject to payment of margins as applicable to transactions of other investors. TMs/CMs/Custodian shall be exempted from collecting upfront margins in respect of Institutional transactions. Institutional trades shall be margined on a T+1 basis with the margin being collected from the custodian upon confirmation of trade. For this purpose Institutional investors shall include

a. SEBI registered category I & II FPIs[64] (who are not corporate bodies, individuals or family offices) as per SEBI FPI regulation 2019 (FPI),
b. Mutual Funds,
c. Public Financial Institutions as defined under as defined under section 2(72) of the Companies Act, 2013 or any subsequent amendments thereof.,
d. Banks, i.e., a banking company as defined under Section 5(1)(c) of the Banking Regulations Act 1949,
e. Insurance companies registered with IRDA,
f. Pension Fund registered with PFRDA.

In respect of institutional transactions confirmed by the custodians the margins shall be levied on the custodians. In respect of institutional transactions rejected/not accepted by the custodians the margins shall be levied on the members who have executed the transactions.

**Risk management for Call auction in Pre-open session:**

[64] The trades of FPIs shall be margined on a T+1 basis. However, the trades of Category II FPIs who are corporate bodies, Individuals or Family offices shall be margined on an upfront basis as per the extant margining framework for non-institutional trades. .

Call auction in the pre-open session follow order- level risk management. All orders received during this session shall be validated against applicable margins to ensure the sufficiency of available capital prior to order acceptance . If a member's available capital is insufficient to cover the margin requirement of an order , that order shall not be accepted for the pre-open session..

**Risk Management for Call Auction in Pre-open session for Initial Public Offering (IPO) and Re-listed scrips**

All orders received during the pre-open session shall be validated against applicable margins to ensure the sufficiency of available capital prior to order acceptance If the available capital of the member is insufficient to cover the margin requirement of the order placed, the ordershall not be accepted for the pre-open session.

#### 4.1.1.3 Shortfall of Margins

Non-fulfilment of either whole or part of the margin obligations by clearing member will be treated as a violation of the rules, bye-laws and regulations of the clearing agency and will attract penalty. In case of any shortfall in margin, the Clearing Corporation may advise the Exchange to withdraw any or all of the membership rights of the clearing member including the withdrawal of trading facilities of all trading members and/ or clearing facility of custodial participants clearing through such clearing members. In addition, the clearing agency may, at its discretion and without further notice to the clearing member, initiate disciplinary actions. These may include inter-alia :closing out outstanding positions, imposing penalties, collecting appropriate deposits, invoking bank guarantees/ fixed deposit receipts, etc.

#### 4.1.1.4 Base Minimum Capital [65]

The base minimum capital for trading members in cash, derivatives and debt segment (based on their risk profiles) is shown in Table 4.3 below.

[65] SEBI Circular No. MRD/DRMNP/36/2012 dated December 19, 2012, and SEBI Circular No. MRD/DRMNP/37/2013 dated December 19, 2013.

**Table 4.3: Base Minimum Capital Requirement of Members**

| Categories | BMC Deposit |
|---|---|
| Only Proprietary trading without Algorithmic trading (Algo) | Rs 10 Lacs |
| Trading only on behalf of Client (without proprietary trading) and without Algo | Rs 15 Lacs |
| Proprietary trading and trading on behalf of Client without Algo | Rs 25 Lacs |
| All Brokers with Algo | Rs 50 Lacs |

- The BMC deposit is meant to meet contingencies in any segment of the Exchange.
- For members who are registered on more than one segment of the same Exchange, the highest BMC deposit across various segments is applicable.
- No exposure is granted against BMC deposit. The BMC deposit shall be maintained for meeting contingencies in any segment of the exchange.
- The Stock Exchanges shall be permitted to prescribe suitable deposit requirements, over and above the SEBI prescribed norms, based on their perception and evaluation of risks involved.
- Minimum 50 percent of the deposit shall be in the form of cash and cash equivalents.
- For stock brokers of exchanges not having nation-wide trading terminals, the deposit requirement shall be 40% of the above said BMC deposit requirements.
- Stock Exchanges shall maintain the BMC at Rs. 1 lakh if the average daily turnover is less than Rs.1 crore for any three consecutive months.

#### 4.1.1.5 Additional Margins

Exchanges/clearing corporations have the right to impose additional risk containment measures over and above the risk containment system mandated by SEBI. However, the Stock Exchanges should keep the following factors in mind while taking such action:

Additional risk management measures (like ad-hoc margins) would normally be required only to deal with circumstances that cannot be anticipated or were not anticipated while designing the risk management system. If ad-hoc margins are imposed with any degree of regularity, exchanges should examine whether the circumstances that give rise to such margins can be reasonably anticipated and can therefore be incorporated into the risk management system mandated by SEBI. Any additional margins that the exchanges may impose shall be based on objective criteria and shall not discriminate between members on the basis of subjective criteria.

#### 4.1.1.6 Provision of early pay-in

Necessary systems have been put in place by clearing corporations to enable early pay-in of funds and securities by the trading members/clearing members. In cases where early pay-in of funds is made by the members, the outstanding position to that extent of early pay-in shall not be considered for computing the margin obligations.

In cases where early pay-in of securities is made, the outstanding position to the extent of early pay-in shall not be considered for margin purposes. If Early Pay-In (EPI) of securities has been made to the Clearing Corporation (CC), then all margins would deemed to have been collected and penalty for short /non-collection of margin including other margins shall not arise.

Further, SEBI, vide circular no. CIR/HO/MIRSD/DOP/P/CIR/2021/595 dated July 16, 2021, introduced block mechanism in the demat account of clients undertaking sale transactions, for ease of operations in Early Pay-in mechanism. CC will match the client level net obligations with the Block details provided by depositories and CC will provide EPI benefit to client if the client level net obligation exists for that client. The facility of block mechanism made mandatory for all Early Pay-In transactions with effect from November 14, 2022. However, the block mechanism shall not be applicable to clients having arrangements with custodians registered with SEBI for clearing and settlement of trades. When the client intends to block securities for a sale transaction, shares will remain blocked in favour of CC. If securities are blocked in favour of CC, then all margin would deemed to have been collected and penalty for short or non-collection of margin including other margins shall not arise.

#### 4.1.1.7 Pre-trade Risk Controls

There are various pre-order (checks which are applicable before order entering into the trading system) and Pre-trade (checks which are applicable before execution of trade) checks which are available on TWS and trading system of the Exchange. Certain checks are monitored by trading member and certain checks are monitored by Exchange trading system. Some of the pre-order and pre trade checks are given below. Pre-trade risk control helps to prevent aberrant orders or uncontrolled trades.

While placing an order on a security which is under surveillance measure such as GSM, ASM, ESM, Unsolicited SMS or Videos, etc. an alert message will be provided on trading terminal.

**Pre-order checks**

**Value/Quantity Limit per order:**

Any order with value exceeding Rs. 10 crore per order cannot be accepted by the Stock Exchange for execution in the normal market. The Stock Exchange(s) are also required to

ensure that appropriate checks for value and/or quantity are implemented by the stock brokers based on the respective risk profile of their clients.

**Cumulative limit on value of unexecuted orders of a stock broker**

Stock Exchanges have been directed to ensure that the trading algorithms of the stock brokers have a 'client level cumulative open order value check'.[66]This means that the stock brokers should put-in place a mechanism to limit the cumulative value of all unexecuted orders placed from their terminals to below a threshold limit set by the stock brokers.

**Dynamic Price Bands**

In 2001, SEBI had advised the Stock Exchanges to implement appropriate individual scrip wise price bands (in either direction—upward or downward), for all scrips in the compulsory rolling settlement. The price band is range from 2% to 20%. The concept of price band was not applicable to scrips on which derivatives products are available. However, for scrips on which no price bands are applicable, Stock Exchanges have implemented a mechanism of dynamic price bands. This mechanism prevents the acceptance of orders for execution that are placed beyond the price limits set by the Stock Exchanges. SEBI further issued a circular to modify the existing dynamic price band mechanism for scrips in the derivatives segment.[67] The changes aim to strengthen volatility management, minimize information asymmetry and enhance market stability. Stock exchange shall set the dynamic price bands at 10% of the previous day's closing price / adjusted base price for the following securities/contracts: Stocks on which derivatives products are available, Index futures and Stock futures.

The dynamic price band formulation for cash and derivatives markets includes uniform price band adjustments across exchanges when a scrip's band is flexed on a single exchange. It features tiered flexing with increasing cooling-off periods (5%, 3%, 2% adjustments after 15, 30, and 60 minutes respectively) and sliding price bands where the opposite band adjusts concurrently. Options markets also see temporary price floors or ceilings during the underlying scrip's cooling-off period, which are removed after the band is flexed.

**UCC/PAN check**

Trading member can put this check to ensure that order is not entered for unregistered client. Exchange system does not allow order entry for those clients whose UCC/PAN is not uploaded on Exchange system.

[66] Vide SEBI circular CIR/MRD/DP/09/2012 dated March 30, 2012.

[67]https://www.sebi.gov.in/legal/circulars/may-2024/enhancement-of-dynamic-price-bands-for-scrips-in-the-derivatives-segment_83574.html

**Pre-trade checks**

- Trade Execution Range: Orders shall be matched, and trades shall take place only if the trade price is within the trade execution range based on the reference price of the contract, which is applicable in derivatives segment.
- Self-Trade Check: Pro / Client orders entered by same/different members are resulting in self-trade due to same PAN or CP code, as the case may be, on the active and passive side, the same shall result in active or passive order will get cancelled due to self-trade checks .
- Market price protection: market with protection order is a combination of market and limit order. It allows the market order to be executed till a specified level mentioned by trader. The risk of an order getting executed at any price is protected by using such order.
- Kill Switch: This will facilitate member to cancel all outstanding order with one single command.
- Cancel on Logout (COL): If member / user entered order with COL, all outstanding order of the user will get cancelled once user get logout from the TWS.

**Index based Market wide Circuit Breaker**[68]

These circuit breakers are used to stop extreme movements either way. The circuit breakers are applied at three stages of the index movement either way at 10%, 15% and 20%. The market wide circuit breakers would be triggered by movement of either BSE Sensex or the NSE Nifty 50 whichever is breached earlier.

<table>
<tr><th>Time of Breach of Index Movement</th><th>10% Movement</th><th>15% Movement</th><th>20% Movement</th></tr>
<tr><td>Before 1:00 PM</td><td>Trading shall be halted for 1 hour</td><td>Trading shall be halted for 2 hours</td><td rowspan="3">Trading shall be halted for the remainder of the trading day</td></tr>
<tr><td>At or after 1:00 PM but before 2:00 PM</td><td rowspan="2">Trading shall be halted for 30 minutes</td><td>Trading shall be halted for 1 hour</td></tr>
<tr><td>At or after 2:00 PM but before 2:30 PM</td><td>Trading shall be halted for the</td></tr>
</table>

[68] Master Circular for Stock Exchanges and Clearing Corporations (Chapter 1-"Trading" refer section 2.1 & 2.2)

| | | | |
|---|---|---|---|
| **At or after 2:30 PM** | **No trading halt** and the market shall continue trading | **remainder of the trading day** | |

**4.1.1.8 Risk Reduction Mode**

Stock Exchanges/Clearing Corporation shall ensure that the stock brokers are mandatorily put in risk-reduction mode when specific percent (currently 90%) of the stock broker's collateral available for adjustment against margins gets utilized on account of trades that fall under a margin system. Such risk reduction mode shall include the following:

- All unexecuted orders shall be cancelled once stock broker breaches 90 percent collateral utilization level.
- Only orders with Immediate or Cancel attribute shall be permitted in this mode.
- All new orders shall be checked for sufficiency of margins. Fresh order placed by member to reduce the open position will be accepted. Fresh order that increase the position shall be checked for the sufficiency of margin and order that do not satisfy the sufficiency of margins will be rejected.
- Non-margined orders shall not be accepted from the stock broker in risk reduction mode.
- The stock-broker shall be moved back to the normal risk management mode as and when the collateral of the stock-broker is lower than percent utilization level specified by the clearing corporation from time to time (currently 85%).

Additionally, when the member is in risk reduction mode.

- Members shall not be allowed to place orders with custodial participant code.
- Client and Custodial Participant code modification shall not be permitted.

With implementation of "Segregation and monitoring of collateral at client level", for monitoring of the risk reduction mode (90% utilization or such applicable limit), the following procedure shall be adopted:[69]

- TM level risk reduction mode: Client margin in excess of 90% of the client collateral shall be identified for each client under a TM. The total of such client margin in excess of 90% of the client collateral, plus the proprietary TM margin shall be assessed against the TM proprietary collateral for monitoring of TM level risk reduction mode.
- CM level risk reduction mode: Sum of client margin in excess of 90% of the client collateral for each client under a TM plus the proprietary TM margin, in excess of 90% of TM proprietary collateral shall be calculated as TM margin in excess of

[69] https://www.sebi.gov.in/legal/circulars/jul-2021/segregation-and-monitoring-of-collateral-at-client-level_51265.html

90% of TM collateral. Sum of such margin for each TM clearing through a CM, plus sum of client margin in excess of 90% of the client collateral for each client clearing through such CM, plus the proprietary CM margin shall be assessed against the proprietary CM collateral for monitoring of CM level risk reduction mode.

### 4.1.2 Risk Management Framework for Derivatives (Equity Future and Option) Segment

Risk Management framework for derivatives will consist of the following:

- Margins
- Liquid Net worth & Liquid Assets
- Pre-trade risk control
- Risk Reduction Mode
- Position Limits

We will study risk management framework for equity derivatives segment in this section.

#### 4.1.2.1 Types of Margins

**Initial Margin Computation**

Initial margin is payable on all open positions of clearing members, up to client level and shall be payable upfront by Clearing Members in accordance with the margin computation mechanism adopted by the Clearing Corporation. Initial margin shall include SPAN margins, Margin on consolidated crystallized obligation, delivery margins and such other additional margins that may be specified by the clearing Corporation from time to time.

Initial margin for client positions shall be netted at the level of individual client and grosses across all clients, at the trading/clearing member level, without any set-offs between clients. Initial margin requirement for proprietary positions shall be netted at trading/clearing member level without any set-offs between client and proprietary positions. The margins computed shall be aggregated first at the trading member level and then aggregated at the clearing member level.

Clearing Corporation adopted SPAN[70] system for the purpose of real time initial margin computation. The SPAN methodology shall be adopted to take an integrated view of the risk involved in the portfolio of each individual client. Initial Margin requirement shall be based on a worst scenario loss of a portfolio of an individual client comprising his positions in options and futures contracts on the same underlying across different maturities and across various scenarios of price and volatility changes. Initial margin requirements shall be based

[70] It is a product developed by Chicago Mercantile Exchange (CME) and is extensively used by leading stock Exchanges of the world. SPAN® uses scenario-based approach to arrive at margins. It generates a range of scenarios and highest loss scenario is used to calculate the SPAN margin.

on 99% value at risk (VaR) over a time horizon as determined by Margin Period of Risk of each product. Value-at-risk (VaR) is a measure of maximum likely price change over a given interval (called "horizon") and at a given confidence level (called "percentile"). SPAN margining uses VaR to compute initial margin but improves upon it with two modifications. It generates 16 "what-if" scenarios. The second and more important feature of SPAN margin is that it considers the entire portfolio of an investor for computing the portfolio-wide margin. The margin is not computed for each position separately. The methodology for computation of value at risk percentage shall be as per the recommendations of SEBI from time to time.

**Margin Period of Risk (MPOR)**

SEBI has advised Clearing corporation to estimate appropriate MPOR, subject to minimum of 2 days, for each equity derivatives product based on liquidity therein and scale up the initial margins.

**Updation of Risk Parameters**

The computation of Worst Scenario Loss has two components. The first is the valuation of the portfolio under sixteen scenarios. At the second stage, these Scenario Contract Values are applied to the actual portfolio positions to compute the portfolio values and the initial margin (Worst Scenario Loss). For computational ease, exchanges are permitted to update the Scenario Contract Values only at discrete time points each day and the latest available Scenario Contract Values would be applied to member/client portfolios on a real time basis.

In order to ensure that the most recent scenario are applied for computation of the portfolio values and the initial margin, the scenario contract values shall be updated at least 5 times in the day, which may be carried out by taking the closing price of the previous day at the start of trading and the prices at 11:00 a.m., 12:30 p.m., 2:00 p.m., and at the end of the trading session.

**Calendar Spread Charge**:

In the case of futures and options contracts on index and individual securities, the margin on calendar spread positions shall be calculated on the basis of delta of the portfolio consisting of futures and options contracts in each month. A portfolio consisting of a near month option with a delta of 100 and a far month option with a delta of –100 would bear a spread charge equal to the spread charge for a portfolio which is long 100 near month futures and short 100 far month futures.

| Product | Calendar Spread Charge |
|---|---|
| Index Derivatives | 1.75% of the far month contract |
| Single Stock Derivatives | 2.2% of the far month contract |

**Removal of calendar spreads on expiry day**

Expiry day can see significant basis risk, where the value of a contract expiring on the day can move very differently from the value of similar contracts expiring in future. Given the relatively very large volumes witnessed on the expiry day vis-à-vis future expiry days, and the enhanced basis risk that it represents, SEBI has decided that the benefit of offsetting positions across different expiries ('calendar spread') shall not be available on the day of expiry for contracts expiring on that day. SEBI vide circular dated February 05, 2026[71], clarified that existing margin calculations for calendar spread positions shall remain unchanged for all expiries except forcontracts expiring on a given day. Lllustration: If monthly expiries fall on 29th (current month), 30th (next month) and 31st (far month) respectively, then calendar spread positions involving positions expiring on 29th (current month) and 30th (next month), or 29th (current month) and 31st (far month), shall not receive calendar spread treatment on 29th (current month expiry). Calendar spread positions involving the positions expiring on 30th (next month) and 31st (far month) shall continue to receive calendar spread treatment on 29th (current month expiry).

**Margin on consolidated crystallized obligation**

The margin on consolidated crystallized obligation in derivatives shall represent:

| | |
|---|---|
| On Intra-day Basis | Payable crystallized obligations based on the closed-out futures positions and payable/receivable premium at client level. |
| At end-of-day basis | Payable obligations at client level considering all futures and options positions. |

**Intraday basis**

On intraday basis, the net payable/receivable amount at client level shall be calculated using:

1. Premium payable/receivable

2. Futures crystallized profit or loss (calculated based on weighted average prices of trades executed).

If the overall amount at client level is payable, such amount shall be the intraday consolidated crystallized obligation margin for the client.

**End-of-day basis**

[71] https://www.sebi.gov.in/legal/circulars/feb-2026/review-of-calendar-spread-margin-benefit-in-single-stock-derivatives-on-expiry-day_99533.html

At the end of day, the payable/receivable amount at client level shall be calculated using:

1. Futures mark to market profit/loss to be settled
2. Options premium payable/receivable
3. Options exercise/assignment for expired contracts
4. Futures final settlement for expired contracts

If the overall amount at client level is payable, such amount shall be the end of-day consolidated crystallized obligation margin for the client. The margin on consolidated crystallized obligations shall be released on completion of settlement.

To make the risk management system more robust, the payment of MTM is mandatorily to be paid by all members before start of trading on the next day.

**Net Option Value**

Net Option Value is computed as the difference between the long option positions and the short option positions, valued at the last available closing price of the option contract and shall be updated intraday at the current market value of the relevant option contracts at the time of generation of risk parameters The Net Option Value shall be added to the Liquid Net Worth of the clearing member. This means that the current market value of short options will be deducted from the Liquid Net Worth and the market value of long options will be added thereto. Thus, mark to market gains and losses on option positions will get adjusted against the available Liquid Net Worth. Mark to market gains and losses shall not be settled in cash for options positions.

**Upfront collection of Option Premium from options buyers**

Options prices move in a non-linear way and carry very high implicit leverage. These are timed contracts with the possibility of fast-paced price appreciation or depreciation. In order to avoid any undue intraday leverage to the end-client, and to discourage any practice of allowing any positions beyond the collateral at the end-client level, SEBI has decided to mandate collection of options premium upfront from option buyers by the Trading Member (TM)/Clearing Member (CM). SEBI has mandated the upfront margin collection requirement shall also include net options premium payable at the client level. The same may be included in the intraday snapshots conducted by Clearing Corporations for verification of upfront collection of margins, and for imposition of penalty in the event of non-compliance.

This requirement would be applicable for equity derivatives segment from February 01, 2025.

**Delivery Margins**

Delivery margins shall be levied on lower of potential deliverable positions or in-the-money long option positions four (4) days prior to expiry of derivative contract which must be settled through delivery. Example- If expiry of derivative contract is on Thursday, the delivery margins on potential in-the-money long option position shall be applicable from previous Friday EOD.

**Extreme Loss Margin**

Clearing members shall be subject to extreme loss margins in addition to initial margins.:

| Product | Extreme Loss Margin |
|---|---|
| Index Futures | 2% of the notional value of the gross open positions in futures contracts, based on the last available trading price of the relevant futures contract |
| Single Stock Futures | 3.5% of the notional value of the gross open positions in futures contracts, based on the last available trading price of the relevant futures contract |
| Short Index Options | 2% of the notional value of the short open position |
| Short Stock Options | 3.5% of the notional value of the short open position |

Notes:

1. In case of calendar spread positions in futures contracts, extreme loss margin shall be levied on one third of the value of the open position of the far month futures contract. Furthermore, the ELM for calendar spread positions on futures, where one of the legs expires on the same day, shall be computed without considering such futures positions as offsetting calendar spread position.

2. In case of index options contracts that are deep out of the money (i.e., strikes out of the money by more than 10% from the previous day closing underlying price), the applicable Extreme Loss Margin shall be 3%.

3. In case of index option contracts with residual maturity of more than 9 months, the applicable Extreme Loss Margin shall be 5%.

4. In case of single stock options contracts that are deep out of the money (i.e., strikes out of the money by more than 30% from the previous day closing underlying price), the applicable Extreme Loss Margin shall be 5.25%.

**Increase in tail risk coverage on the day of options expiry**

Extreme Loss Margin is levied with a view to cover tail risk outside the scanning risk. On the day of options contracts expiry, given the heightened speculative activity around options positions and the attendant risks, it has been decided to increase the tail risk coverage by levying an additional ELM of 2% for short options contracts. This would be applicable for all open short options at the start of the day, as well on short options contracts initiated during the day that are due for expiry on that day. This requirement has been made applicable for index option contract.

**Additional Margin on High Volatile Stocks**

For securities with Intra-day (maximum of [High-Low], [High-Previous Close], [Low-Previous Close]) price movement of more than 10% in the underlying market for 3 or more days in last one month, the minimum total margins (SPAN margins, Extreme Loss Margin and Additional margin) shall be equal to the maximum intraday price movement of the security observed in underlying market in last one month. The same shall be continued till expiry date of derivative contracts which falls after completion of three months from date of levy. For securities with Intra-day (maximum of [High-Low], [High-Previous Close], [Low-Previous Close]) price movement of more than 10% in the underlying market for 10 or more days in last six months; the minimum total margins (SPAN margins, Extreme Loss Margin and Additional margin) shall be equal to the maximum intraday price movement of the security observed in underlying market in last six months. The same shall be continued till expiry date of derivative contracts which falls after completion of one year from date of levy.

**Additional Margin**

Exchanges/clearing corporations have the right to impose additional risk containment measures over and above the risk containment system mandated by SEBI. Some of the additional margins are Surveillance Margin, Additional Margin for highly volatile stock, additional margin for security in ban period, additional margin for client concentration etc. Further, in certain cases where strike price is certain % away from the closing price the net short value shall be collected in cash from clearing member on T+1 day (Along with funds settlement). The cash collected shall be retained with Clearing Corporation till expiry of contract or till square-up of short positions.

**Cross Margining**

In order to improve the efficiency of the use of the margin capital by market participants SEBI has introduced cross margin across Cash and Equity Derivatives segment and made available to all categories of market participants. [72] The positions of clients in both the Cash market and F&O segments to the extent they offset each other shall be considered for the purpose of cross margining. Position eligible for cross margining benefit: -

[72] SEBI Circular Ref. No.: SEBI/DNPD/Cir-44/2008 dated December 02, 2008

a. Index futures and constituent stock futures in F&O segment
b. Index futures and constituent stock positions in Capital market segment
c. ETF and constituent stock futures in F&O segment
d. ETF and constituent stock positions in Capital market segment
e. Index futures and ETF in Capital market segment
f. Stock futures in F&O segment and corresponding underlying stock positions in Capital market segment
g. Index Futures contract in F&O Segment on eligible equity indices
h. Off-setting position in highly correlated indices[73].

A basket of positions in index constituent stock/stock futures, which is a complete replica of the index in the ratio specified by the Exchange/Clearing Corporation, shall be eligible for cross margining benefit. The constituents and the number of units of the constituent stocks/ stock futures required in the basket to be considered as a complete replica of the ETF shall be the same as that of the respective underlying Index for availing cross margin benefit.

Client can avail cross margin benefit in both the scenario namely when a same Clearing Member clears for client/ entities in Cash and Derivatives segments and when different Clearing Members clear for client/entities in Cash and Derivatives segments. The positions in the derivatives segment for the stock futures and index futures shall be in the same expiry month to be eligible for cross margining benefit. In such case a spread margin of 25% of the total applicable margin on the eligible offsetting positions, as mentioned above, shall be levied in the respective cash and derivative segments. In respect of positions which are eligible for offset in Index Futures contract on eligible equity indices pairs the spread margin shall be 30% of applicable upfront margin on the offsetting positions.

The cross margin benefit on offsetting positions also extended for different expiry dates subject to the following:

a. A spread margin of 40% would be levied in case of offsetting positions in correlated indices having different expiry dates. Spread margin of 30% would continue to get levied in case of same expiry date (i.e. existing requirement).
b. A spread margin of 35% would be levied in case of offsetting positions in index and its constituents having expiry date different from index. While the expiry date of index futures can be different from that of its constituents, the expiry date of futures contracts of all constituents should be same in order to obtain the aforesaid cross margin benefit.

[73] Highly correlated indices: Positive correlation of more than 0.90; Atleast 80% of constituents of one index is present in other index; and the constituents of smaller index based on free float market capitalization shall have at least 80% weightage in the larger index based on free float market capitalization.

c. The aforesaid spread margin benefit would be revoked at the beginning of the expiry day of the position which expires first (i.e. first of the expiring indices or constituents) in case the expiry dates of both legs of the position are different.

Cross margining benefit shall be computed at client level on an online real time basis and provided to the trading member/clearing member/custodian, as the case may be, who, in turn, shall pass on the benefit to the client. For institutional investors, however, the cross margining benefit shall be provided after confirmation of trades.

SEBI vide circular dated November 30, 2022, allow net settlement of cash segment and futures & options (F&O) segment upon expiry of stock derivatives. Hence, the positions in stocks derivative contracts that are converted to settlement by delivery on expiry in F&O segment and obligations in the underlying Capital Market segment shall be allowed margin benefit to the extent of offsetting positions.

**4.1.2.2 Liquid Net Worth and Exposure Limits of a Clearing Member**

**Liquid Net Worth**

The Liquid Net Worth is defined as the total liquid assets deposited with the Exchange/Clearing Corporation towards initial margin and capital adequacy, LESS

initial margin, and extreme loss/exposure margin applicable to the total gross open positions at any given point of time on all trades to be cleared through the clearing member.

The clearing member's liquid net worth shall not be less than Rs. 50 lacs at any point of time.

**Liquid Assets**

Candidate may refer "Liquid Asset" section 4.1.1.2.

**4.1.2.3 Pre-trade risk control and Risk Reduction Mode**

With the view to ensure orderly trading and market integrity, like cash segment stock exchanges/clearing corporation has implemented pre-trade risk controls in derivatives segment like quantity freeze, price band, dynamic price band, trade execution range, self-trade check etc.

With a view to facilitating informed decision making by the investors trading in derivatives segment, SEBI has introduced 'Risk disclosures' with respect to trading in equity Futures & Options (F&O) segment. Accordingly, all stock brokers mandated to display the 'Risk disclosures' given by SEBI on their websites and to all their clients in the manner as specified below:

Upon login into their trading accounts with brokers, the clients may be prompted to read the 'Risk disclosures' (which may appear as a pop-up window upon login) and shall be allowed to proceed ahead only after acknowledging the same.

The 'Risk disclosures' shall be displayed prominently, covering at least 50 percent area of the screen. SEBI mandated stock-broker, upon login by client in trading accounts with brokers, the clients may be prompted to read the 'Risk disclosures' related to equity derivatives (which may appear as a pop-up window upon login) and shall be allowed to proceed ahead only after acknowledging the same. The 'Risk disclosures' shall be displayed prominently, covering at least 50 percent area of the screen.

Similar to cash segment, in derivatives segment also Stock Exchanges/Clearing Corporation shall ensure that the stockbrokers are mandatorily put in risk-reduction mode when specific percent (currently 90%) of the stock broker's collateral available for adjustment against margins gets utilized on account of trades that fall under a margin system.

For additional information you can refer to the section 4.1.1.7 & 4.1.1.8.

### 4.1.2.4 Position and Exposure Limits

SEBI has prescribed various kinds of position limit and Exposure limits in Derivatives Segment. These position limits may be applicable at the instrument level (stock derivatives/index futures/index options), stock-broker level, or clearing member level, limits for FPIs/MFs, non-institutional clients, and market wide position limits etc. Exchanges and Clearing Corporation must implement necessary procedures to monitor these limits. Violation of these limits attracts penal action against the participants.

SEBI vide circular dated May 29, 2025, provided various measures for enhancing trading convenience and strengthening risk monitoring in equity derivatives.[74] Few important points are given below. Candidates may refer the circular for additional details.

- **Open Interest**: Open Interest(OI)of the participants in derivatives shall be measured at a portfolio level by computing the net Delta adjusted open positions across futures and options for an underlying at a given point in time. Delta denotes sensitivity of price movement of derivative position with respect to that of the underlying. Accordingly, long futures have a delta of +1 times notional. For options, delta will range between 0 and +1 times notional for long calls and between 0 and –1 times notional for long puts. In case of short options position, effective delta for short calls is negative and that of short put is positive. Gross addition of such net Future Equivalent Open Interest (FutEq OI) across all Unique Client Codes (UCCs) would form the FutEq OI for the Stock/Index Derivatives as illustrated below:

[74]https://www.sebi.gov.in/legal/circulars/may-2025/measures-for-enhancing-trading-convenience-and-strengthening-risk-monitoring-in-equity-derivatives_94293.html

| Scrip 1 | Long Position in Futures | Long Position in Call | Delta of long Call | Long Position in Put | Delta of long Put | Short Position in Put | Delta of Put | Short Position in Call | Delta of call | Notional OI | FutEq OI |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Client 1 | 300 | | | | | | | | | 300 | 300 |
| Client 2 | | 500 | 0.5 | | | | | | | 500 | 250 |
| Client 3 | 300 | 500 | 0.5 | 400 | -0.5 | | | | | 1200 | 350 |
| Client 4 | | | | | | -400 | -0.5 | -400 | 0.5 | 800 | 0 |
| **Market wide OI** | | | | | | | | | | **2800** | **900** |

- **Market Wide Position Limit (MWPL) for single stock**: The MWPL shall be lower of 15% of free float and 65x Average Daily Delivery Value (ADDV) across CCs with a floor limit of 10% of free float. Once the market wide Open Interest for any scrip exceeds 95% of the MWPL for the scrip, the members/clients shall trade only to decrease their positions through offsetting positions (this is called ban period). SEBI has clarified that passive increase in position on account of movement in script (delta) shall not be considered a breach. For details candidates are requested to refer SEBI circular.

- **Position Limits for Index Futures and Index Options**: In order to strike a balance between market stability / fear of manipulation of underlying constituents associated with a large size index position and the ability to take meaningful exposure by participants, SEBI has revised position limit for index futures and index options at PAN level. Positions of market participants in the equity derivatives segment (index) shall also be monitored based on total Open Interest of the market at the end of previous day's trade. In case of a drop in market OI compared to the previous day's market OI, market participants may breach the specified position limits even if their positions have remained unchanged/reduced throughout the day. Such cases of passive breaches shall not be considered as violation.

- **Pre-open session for the derivatives market**: The pre-open session to be extended to current-month futures contracts on both single stocks and indices, mirroring the modalities of the cash market's pre-open and post-closing sessions. In the last five trading days before expiry, these sessions shall extend to next-month futures contracts as liquidity shifts from one expiry to the other on account of rollover of futures contracts.

**Intraday monitoring of position limits**

The position limits for index derivatives contracts as specified by SEBI from time to time are being monitored by Stock Exchanges/Clearing corporations at the end of day. Particularly amidst the large volumes of trading on expiry day, there is a possibility of undetected intraday positions beyond permissible limits during the course of the day. To address the aforesaid risk of position creation beyond permissible limits, it has been

decided that existing position limits for equity index derivatives shall be monitored intra-day by exchanges.

Based on observed instances of outsized intraday FutEq positions created by certain entities in index options on of contract expiry days, and the resulting risks to market integrity ,SEBI has decided to implement an entity level intraday monitoring framework for index options. This framework aims to ensure market stability, while facilitating participation by various market participants, including liquidity providers and market makers. Intraday limits shall continue to be monitored by Stock Exchanges through a minimum of four random snapshots during the trading day.[75]

### 4.1.3 Margin Collection by Clearing Corporation

- The initial margin and extreme loss margins shall be payable upfront by the clearing members. Clearing/Trading members are required to collect initial margins and extreme loss margins from their client/constituents on an upfront basis.
- Clearing members shall provide for margin in any one or more of the eligible collateral modes as detailed in the section “Liquid Asset” as mentioned in the above paragraphs.
- Clearing member can deposit the liquid asset in combination of various liquid assets in a manner and within a limit as specified by clearing corporation from time to time.
- Clearing members shall be permitted to provide “own” securities or trading member proprietary securities or client securities towards the margin deposit requirements.
- Clearing members can re-pledge client/trading member (TM) proprietary securities only through Margin Pledge facility provided by NSDL and CDSL.
- Clearing Member shall ensure that sufficient collateral is allocated to TM Prop/CP/Clients to cover their margin requirements. However, if the margin applicable at clearing corporation for a TM Prop/CP/Client in a segment exceeds the collateral allocated to the TM Prop/CP/Client plus the securities collateral re-pledged to CC in the respective segment., then the proprietary collateral of TM/CM shall be locked. Such margin blocked from the proprietary collateral towards a TM Prop/CP/Client margin shall have deemed allocation of TM’s proprietary collateral towards client’s margin and deemed allocation of CM’s proprietary collateral towards TM Prop/CP/Client margins.
- CM shall ensure that allocated collateral plus value of securities collateral re-pledge to Clearing Corporation for a TM Prop/CP/Client is all time greater than or equal to minimum margin collection requirement for respective TM Prop/CP/Client in the respective segment.

[75] https://www.sebi.gov.in/legal/circulars/sep-2025/framework-for-intraday-position-limits-monitoring-for-equity-index-derivatives_96376.html

- CC's also provide facility to enable clearing members to transfer collaterals from one segment to other segment on an intraday basis.
- CC's also provide facility to release of collateral intra-day as well as at EOD.

### 4.1.4 Margins from the Client

Trading Members/Clearing Members should have a prudent risk management system to protect themselves against the default made by their clients. Margins constitute an important element of risk management systems and are required to be well documented and made accessible to the clients and the Stock Exchanges

In the **Capital Market Segment**, TMs/CMs must mandatorily collect a minimum 20% upfront margin (covering VaR and ELM) from clients before trade execution. While other margins such as MTM, delivery, and additional margins are due immediately upon being called, members have until the settlement day to finalize collection without incurring penalties, provided the full pay-in of funds and securities is completed. Failure to secure these funds or the 20% upfront requirement by the specific deadline results in prescribed penalties. TMs/CMs are required to report consolidated margin collection and any shortfalls to the Exchange by T+5.

In the **Derivatives Segment**, strict upfront collection is required for Initial Margins, Extreme Loss Margins, and net option premiums from buyers before any trade is initiated. Unlike upfront requirements, delivery margins and margins on consolidated crystallized obligations must be collected by T+1. TMs and CMs must ensure all advance obligations are met to maintain market integrity. Similar to the cash segment, any actual short-collection or non-collection of these various margin components must be reported to the Stock Exchange by the T+5 deadline.

The TM/CM can collect the margin from its client in a various form as specified by SEBI/Exchanges/Clearing Corporation from time to time after taking into account their risk management policy and liquidity aspects. SEBI also provided "Framework to Enable Verification of Upfront Collection of Margins from Clients in Cash and Derivatives segments.[76] Stock Exchange/Clearing Corporation shall levy penalty to TM/CM for short collection/non-collection of margin. All instances of non-reporting shall amount to 100% short collection and the penalty as applicable shall be charged on these instances in respect

[76] SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020

of short collection. If during inspection it is found that a member has reported falsely the margin collected from clients, the member shall be penalized 100% of the falsely reported amount along with suspension of trading in that segment as specified from time to time.

**4.1.4.1 'Mechanism for regular monitoring of and penalty for short collection/ non-collection of margins from clients' in Cash and Derivatives segments.**

With an objective to enable uniform verification of upfront collection of margins from clients by TM/ CM and levy of penalty across segments, SEBI has provided following framework to the Stock Exchanges/ Clearing Corporations :

- Clearing Corporations shall send minimum four snapshots of client wise margin requirement to TMs/CMs for them to know the intraday margin requirement per client in each segment. The number of times snapshots need to be sent in a day may be decided by the respective Clearing Corporation depending on market timings subject to a minimum of four snapshots in a day. The snapshots would be randomly taken in pre-defined time windows.
- The client wise margin file provided by the CCs to TMs/CMs shall contain the EOD margin requirements of the client as well as the peak margin requirement of the client, across each of the intra-day snapshots.
- The member shall have to report the margin collected from each client, as at EOD and peak margin collected during the day, in the following manner:
    - EOD margin obligation of the client shall be compared with the respective client margin available with the TM/CM at EOD.

    AND
    - Peak margin obligation of the client, across the snapshots, shall be compared with respective client peak margin available with the TM/CM during the day.
- Higher of the shortfall in collection of the margin obligations as above, shall be considered for levying of penalty as per the extant framework.
- The verification of availability of margins with TM/ CM, as above, shall be done by exchanges/ clearing corporations on a weekly basis by verification of the balances in the books/ ledgers of the TM/ CM in respect of the client.
- The margin requirements to be considered for the intra-day snapshots in derivatives segments (including commodity derivatives), shall be calculated based on the fixed Beginning of Day (BOD) margin parameters. The BOD margin parameters would include all SPAN margin parameters as well as ELM requirements.
- With effect from May 01, 2023, the End of Day (EOD) margin collection requirement from clients, in derivatives segments (including commodity derivatives), shall also be calculated based on the fixed BOD margin parameters.

### 4.1.5 Mechanism for Client Collateral

In order to strengthen the mechanism of protection of client collateral from misappropriation/ misuse by TM/ CM, default of TM/CM and/or other clients and upfront collection of margin from clients SEBI has issued various measures like:

1. Margin obligations to be given by way of Pledge/ Re-pledge in the Depository System[77]. Some of the salient features are given below:
   - Collateral from clients in the form of securities is allowed only by way of 'margin pledge', created in the Depository system
   - Depositories provides a separate pledge type viz. 'margin pledge', for pledging client's securities as margin to the TM / CM. The TM / CM shall open a separate demat account for accepting such margin pledge, which shall be tagged as 'Client Securities Margin Pledge Account'.
   - For the purpose of providing collateral in form of securities as margin, a client shall pledge securities with TM, and TM shall re-pledge the same with CM, and CM in turn shall re-pledge the same to Clearing Corporation (CC). The complete trail of such re-pledge shall be reflected in the de-mat account of the pledgor.
   - The TM shall re-pledge securities to the CM's 'Client Securities Margin Pledge Account' only from the TM's 'Client Securities Margin Pledge Account'. The CM shall create a re-pledge of securities on the approved list to CC only out of 'Client Securities Margin Pledge Account'.
   - The TM and CM shall ensure that the client's securities re-pledged to the CC shall be available to give exposure limit to that client only.
   - Securities that are not on the approved list of a CC may be pledged in favour of the TM / CM. Each TM / CM may have their own list of acceptable securities that may be accepted as collateral from client.
   - CM shall be allowed to re-pledge acceptable/approved client securities with the CC by furnishing the UCC wise client details. CC shall not allow any exposure to the CM on re-pledged securities of the client / TM.
   - In case of a trade by a client / TM whose securities are re-pledged with CC, the CC shall first block the available collateral provided by CM. However, at periodical interval (latest by end of day), CC shall release the blocked securities collateral of CM to the extent of re-pledged securities collateral of that client / TM available with the CC.
   - In case where a client sells securities that are pledged in favor of the TM/CM as Margin pledged securities (including pledged funded stock) orCUSPA pledge, depositories shall provide a functionality of a single instruction in the form of

[77] SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/28 dated February 25, 2020, https://www.sebi.gov.in/legal/circulars/jun-2025/margin-obligations-to-be-given-by-way-of-pledge-re-pledge-in-the-depository-system_94363.html, https://www.sebi.gov.in/legal/circulars/jun-2025/margin-obligations-to-be-given-by-way-of-pledge-re-pledge-in-the-depository-system_94363.html

''Pledge release for early pay in'' to the TM/CM .Under this, the pledge will be released and early pay in block will be set up immediately in client's demat account, subject to pay in validation, i.e. only to the extent of the delivery obligation of that client as provided by the CCs to the depositories, without the need for a physical instruction , electronic instruction or DDPI/POAIn case of invocation of margin pledged securities(including pledged funded stock) of client by Trading member (TM), the invoked securities, other than mutual fund units that are not traded on the exchanges, shall be blocked for early pay-in in the client's demat account with a trail being maintained in TM/CM's 'Client Securities Margin Pledge Account' / 'Client Securities under Margin Funding Account'. The pay in block in client's demat account shall be subject to pay in validation i.e. only to the extent of delivery obligation of that client as provided by CCs to depositories.

- In case of invocation of Mutual fund (MF) units that are not traded on the exchange, depositories shall provide a functionality of single instruction in the form of 'invocation cum redemption' wherein invoked MF units will come to the TM/CM's 'Client Securities Margin Pledge Account', and go for auto redemption from the said account.

2. Framework to enable verification of upfront collection of margins from clients in Cash and Derivatives segments[78]:
   The guideline reiterated that the applicable upfront margins are required to be collected from the clients in advance of the trade. With an objective to enable uniform verification of upfront collection of margins from clients by TM/ CM and levy of penalty across segments, SEBI has specified framework to the Stock Exchanges/ Clearing Corporations for the purpose of 'Mechanism for regular monitoring of and penalty for short-collection/ non-collection of margins from clients' in Cash and Derivatives segments.
3. Execution of 'Demat Debit and Pledge Instruction' (DDPI) for transfer of securities towards deliveries / settlement obligations and pledging / re-pledging of securities[79]. The DDPI shall serve the same purpose of Power of Attorney (PoA) and significantly mitigate the misuse of PoA.
4. Segregation and Monitoring of Collateral at Client Level[80]. Salient features are given below:

[78] SEBI circular SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020, SEBI/HO/MRD2/DCAP/P/CIR/2022/60 dated February 10, 2022, SEBI/HO/MRD/MRD-PoD-2/P/CIR/2023/016 dated February 01, 2023
[79] SEBI circular SEBI/HO/MIRSD/DoP/P/CIR/2022/4 dated April 04, 2022 and
[80] SEBI circular SEBI/HO/MRD2_DCAP/CIR/2021/0598 dated July 20, 2021,
SEBI circular SEBI/HO/MRD2/DCAP/P/CIR/2022/0022 dated February 24, 2022

- With a view to providing visibility of client-wise collateral (for each client) at all levels, viz., TM, CM and Clearing Corporation (CC), a reporting mechanism, covering both cash and non-cash collateral, shall be specified by the CCs.
- TM shall report disaggregated information on collaterals up to the level of its clients to the CM.
- CM shall report disaggregated information on collaterals up to the level of clients of TM and proprietary collaterals of the TMs to the Stock Exchanges (SEs) and CCs in respect of each segment.
- A web portal facility shall be provided by the CCs/ SEs to allow clients to view aforesaid disaggregated collateral reporting by TM/CM.
- The CCs shall use such collateral allocation information to ensure that the collateral allocated to a client is used towards the margin obligation of that client only.
- While depositing other forms of collateral i.e. Cash, Fixed Deposits (FDs), Bank Guarantees (BGs) or Government Securities provided through the SGL/CSGL route, etc., the CM shall allocate these collaterals into proprietary account of CM, and/or proprietary account of any TM clearing through the CM, and/or account of any of the clients (including Custodial Participants(CPs)) clearing through the CM, and/or of any of the clients trading through the TM who in turn is clearing through the CM, segment-wise.
- In case of such collateral received by the CM from any TM, the CM shall not accept the same without the TM specifying break-up of such collateral into proprietary account of the TM and/or uniquely identified client account. Similarly, the CC shall not accept such collateral without the CM specifying appropriate break-up of such collateral into proprietary account of CM/ proprietary account of TM/ client account. The CM shall ensure that the sum of break-up of such collateral provided by TM is equal to the total value of such collateral provided by TM, and that the allocation of such collateral to any entity as reported to the CC does not exceed the allocation of collateral reported by the TM for that entity.
- The members shall ensure that allocated collateral plus value of securities collateral re-pledged to the CC for a client is at all times greater than or equal to the minimum margin collection requirement for the respective client in the respective segment.
- CMs are required to maintain at least 50% of the total collateral in the form of cash or cash equivalents. At individual client level, a client may have allocation of cash equivalent, less than the value of non-cash collateral provided by the client. However, the excess cash-equivalent collateral of proprietary account of TM/CM can be considered for clients trading/clearing through them, for the purpose of monitoring minimum 50% cash-equivalent requirement.
- The terms “Client Collateral”, “TM Collateral”, “CP Collateral” and “CM Collateral” shall mean the total of the allocated collateral value plus the value of demat securities collateral provided through margin pledge/re-pledge by any individual

client, TM, CP and CM respectively to the level of CC. The TM/CM collateral shall mean the proprietary collateral of the TM/CM only and shall not include the collateral of any of their clients.

- On receipt of a trade from a client account by the CC, the margin shall first be blocked from the value of the client collateral. If the client collateral is not sufficient, the residual margin shall be blocked from the TM proprietary collateral of the TM of such client. If the TM proprietary collateral is also not sufficient, then the residual margin shall be blocked from the CM proprietary collateral of the CM of such TM.
- In case of a trade from the proprietary account of a TM, the margin shall first be blocked from the TM proprietary collateral, and in case such collateral is not sufficient, then the residual margin shall be blocked from the CM proprietary collateral.
- Margins based on trades from proprietary account of the CM shall be blocked from the proprietary collateral of the CM only.
- In case of CP trades executed by TMs, the margin shall be blocked in the following order- (i) CP collateral through the executing TM, if any, (ii) residual margin from the proprietary collateral of the executing TM, and (iii) residual margin from the proprietary collateral of the CM of the executing TM. Upon confirmation of such trades by CM of the CP, the margin so blocked prior to the confirmation shall be released, and shall be blocked in the following order- (i) CP collateral through the confirming CM, and (ii) residual margin from the proprietary collateral of the confirming CM. In case of CP trades, the requirement to ensure that sufficient collateral is allocated to clients to cover their margin requirements shall be on the confirming CM. However, if the trade is confirmed under the auto approval facility provided by the CC, then margin shall be directly blocked in the following order- (i) CP collateral through the confirming CM, and (ii) residual margin from the proprietary collateral of the confirming CM.
- CMs shall be permitted to change the allocation of collateral deposited with the CC, subject to the value allocated to any client not exceeding the value of actual collateral received from that client (excluding the securities collateral re-pledged to CC through margin pledge mechanism). For additional details participants are requested to refer the relevant circulars.

5. Upstreaming of clients' funds by Stock Brokers (SBs) / Clearing Members (CMs) to Clearing Corporations (CCs)[81]

   With a view to safeguard clients' funds placed with SBs/CMs, SEBI has decided the upstreaming of all client funds received by SBs/CMs to the Clearing Corporations (CCs).

[81] https://www.sebi.gov.in/legal/circulars/dec-2023/upstreaming-of-clients-funds-by-stock-brokers-sbs-clearing-members-cms-to-clearing-corporations-ccs-_79788.html.

As per the framework, no clients' funds shall be retained by SBs/ CMs on End of Day (EoD) basis. The clients' funds shall all be upstreamed by SB/ CMs to CCs only in the form of either cash, lien on FDR (subject to certain conditions enumerated below), created out of client fund or pledge of units of Mutual Fund Overnight Schemes (MFOS) created out of clients fund. FDRs created by SBs/ CMs out of clients' funds shall be allowed only under certain conditions. SBs/CMs shall ensure that client funds are invested only in such MFOS that deploy funds into risk-free government bond overnight repo markets and overnight Tri-party Repo Dealing and Settlement (TREPS). The bank instruments provided by clients as collateral (i.e. client FDRs and BGs) cannot be up-streamed to CCs and they shall be ineligible to be accepted as collateral in any segment of securities market. The provisions of this framework shall not be applicable to bank-CMs (including Custodians that are banks), and for proprietary funds of SBs/CMs in any segment and SB's proprietary funds deposited with CM in the capacity of a client.

For additional details participants are requested to refer the relevant circulars.

6. Trading supported by Blocked Amount in Secondary Market[82]

In its continuing endeavour to provide protection to the investors from the default of member(s) ['trading member' (TM) / 'clearing member' (CM)] SEBI has decided to introduce a supplementary process for trading in secondary market based on blocked funds in investor's bank account, instead of transferring them upfront to the trading member, thereby providing enhanced protection of cash collateral. The said facility shall be provided by integrating Reserve Bank of India (RBI) approved Unified Payments Interface (UPI) mandate service of single-block-and-multiple-debits with the secondary market trading and settlement process and hereinafter referred as 'UPI block facility'.

Under the proposed framework, funds shall remain in the account of client but will be blocked in favour of the clearing corporation ('CC') till the expiry date of the block mandate or till block is released by the CC, or debit of the block towards obligations arising out of the trading activity of the client, whichever is earlier. Further, settlement for funds and securities will be done by the CC without the need for handling of client funds and securities by the member.

SEBI vide circular dated November 11, 2024, provided following guidelines for ASBA in secondary market:

[82]https://www.sebi.gov.in/legal/circulars/jun-2023/trading-supported-by-blocked-amount-in-secondary-market_73071.html.
https://www.sebi.gov.in/legal/circulars/nov-2024/trading-supported-by-blocked-amount-in-secondary-market_88339.html

- In addition to the current mode of trading, the Qualified Stock Brokers (QSBs) shall provide either the facility of trading supported by blocked amount in the secondary market (cash segment) using UPI block mechanism or the 3-in-1 Trading Account facility, to their clients.
- The 3-in-1 trading account facility offered/ to be offered by the TMs shall, at least have the features as specified in this SEBI circular related to 3-in-1 account.
- Clients of the QSBs will have the option, to either continue with the existing facility of trading by transferring funds to TMs or opt for either of the facilities stated above, as provided by the QSBs

**4.1.6 Providing margin related information to clients**

Stock Brokers on daily basis should send margin related information across all segment to their clients, which shall, inter-alia, include:

- Client code and name, Trade day (T)
- Margin deposit available for the client on day T (with break-up in terms of cash, FDRs, BGs and pledged/re-pledged securities)
- Margin adjustments (including MTM losses) for day T after adjusting MTM profit if any.
- Margin status (balance with the member / due from the client) at the end of T day.

Such margin related information (Daily margin statement) should be issued by Stock Brokers to clients on T-Day itself or by such timelines as may be specified from time to time.

Brokers should maintain proper records of client collateral and to prevent misuse of client collateral

- Brokers should have adequate systems and procedures in place to ensure that client collateral is not used for any purposes other than meeting the respective client's margin requirements/pay-ins. Brokers should also maintain records to ensure proper audit trail of use of client collateral.
- Additionally, every Stock Broker shall maintain proper records of collateral received from clients as under:
    - Receipt of collateral from client and acknowledgement issued to client on receipt of collateral.
    - Client authorization for deposit of collateral with the exchange/ clearing corporation/ clearing house towards margin.
    - Record of deposit of collateral with exchange/ clearing corporation/ clearing house.
    - Record of return of collateral to client.
    - Credit of corporate action benefits to clients.

- The records should be periodically reconciled with the actual collateral deposited with the broker.

In case client collateral is found to be mis-utilized, the broker would attract appropriate deterrent penalty for violation of norms provided under Securities Contract Regulation Act, SEBI Act, SEBI Regulations and circulars, Exchange Byelaws, Rules, Regulations and circulars. Stock-Broker/Clearing Members should have a prudent risk management system to protect themselves against the default made by their clients.

Margins constitute an important element of risk management systems and are required to be well documented and made accessible to the clients and the Stock Exchanges.

### 4.1.7 Enhanced Supervision of Stock Brokers [83]

To strengthen the Risk Management process and to increase investor confidence in the secondary market, SEBI constituted a committee on "Enhanced Supervision of Stock Brokers", which included representatives from all stake holders that gave certain recommendations/guidelines under the aforesaid heading. These guidelines cover the following broad areas:

- Uniform nomenclature to be followed by stock brokers for Naming/Tagging of Bank and Demat Accounts and the reporting of such accounts to the Stock Exchanges/Depositories. All new bank and demat accounts opened by the stock brokers shall be named as per the SEBI specified nomenclature and the details shall be communicated to the Stock Exchanges within one week of the opening of the account.
- Monitoring of Clients' Funds lying with the Stock Broker by the Stock Exchanges, through a sophisticated alerting and reconciliation mechanism, to detect any mis-utilisation of clients fund.
- Changes in the existing system of internal audit for stock brokers/depository participants viz. appointment, rotation of Internal Auditors, formulation of objective sample criteria, monitoring of quality of Internal Audit Reports, timeline for submissions of Internal Audit Reports, etc
- Monitoring of financial strength of stock brokers by stock exchanges so as to detect any signs of deteriorating financial health of stock brokers and serve as an early warning system to take pre-emptive and remedial measures.

[83] SEBI Cir No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 and SEBI Cir. No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2017/123 Dated November 29, 2017.

- Members are required to submit various data related each client on periodic basis. This includes client funds lying with stock broker, holding statement, client fund and securities balance, reporting of financial indicator data etc.
- Clarification on running account viz. time gap between two running account settlement, mode of transfer for funds settlement etc.
- The stock brokers shall provide Permanent Account Numbers of all their Directors, Key Management Personnel and dealers to the Stock Exchanges. Any change in the aforesaid details/information shall be intimated to the Stock Exchanges within seven days of such change.
- Brokers shall not grant further exposure to the clients when debit balances arise out of client's failure to pay the required amount and such debit balances continues beyond the fifth trading day, as reckoned from date of pay-in, except, in accordance with the margin trading facility provided vide SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017, or as may be issued from time to time.

SEBI vide circular[84] dated June 2022 and November 11, 2022 has specified "Naming / Tagging of demat accounts maintained by Stock Brokers". Highlights of the circular are as follows:

- Bank accounts and Demat accounts maintained by all stock brokers shall have appropriate nomenclature to reflect the purpose for which those bank/demat accounts are being maintained.
- The nomenclature for bank accounts and demat accounts to be followed is given as under:
    - SEBI vide circular dated December 13, 2023, has advise to change the nomenclature of all such accounts either of the following two categories of bank accounts.
        - Up Streaming Client Nodal Bank Account (USCNBA): SB/CM shall receive clients' funds in USCNBA. The nomenclature for such accounts shall be "Name of the SB/CM –USCNB account"
        - Down Streaming Client Nodal Bank Account (DSCNBA): Payment to clients shall be done only from DSCNBA account. The nomenclature for such accounts shall be "Name of the SB/CM –DSCNB account".
    - Bank account(s) held for the purpose of settlement would be named as "Name of Stock Broker -Settlement Account".
    - Stock brokers are required to maintain demat accounts only under the 6 categories specified by SEBI.

[84] https://www.sebi.gov.in/legal/circulars/jun-2022/naming-tagging-of-demat-accounts-maintained-by-stock-brokers_59830.html

- All demat accounts maintained by stock brokers should be appropriately tagged.
- Stock broker shall inform the Stock Exchanges of existing and new bank and demat account(s) as per the format specified by SEBI/Exchange.

**Graded Surveillance Measure (GSM), Additional Surveillance Measure (ASM) and Enhanced Surveillance Measure (ESM)[85]**

To enhance market integrity and safeguard interest of investors, SEBI has introduced Graded Surveillance Measures (GSM) on securities which witness an abnormal price rise not commensurate with financial health and fundamentals like Earnings, Book value, Fixed assets, Net-worth, P/E multiple, etc. Similarly, 'Additional Surveillance Measures' (ASM) on securities with surveillance concerns based on objective parameters viz. Price variation, Volatility etc. have been introduced. SEBI and Stock Exchanges have introduced the Enhanced Surveillance Measure(ESM) framework for Micro-Small Companies (market cap of less than 500 crores). This framework was subsequently extended to included Main Board companies with a market capitalization of less than 1,000 crores.. The shortlisting of securities for the ESM framework is based on dynamic parameters including High Low variation, Close to close price variation, Market Capitalisation, Standard Deviation, PE.

The main objective of these measures is:

- To alert and advice investors to be extra cautious while dealing in these securities
- To advice market participants to carry out necessary due diligence while dealing in these securities.

Exchange surveillance team take stage wise surveillance action after inclusion of security in ASM, GSM or ESM. Surveillance action includes 100% margin, Trade for Trade settlement, +/- 2% to 5% price band, trading in periodic call auction mechanism, restricted trading for e.g. once a week, additional deposit etc. The list of securities under ASM, GSM and ESM are made available on Exchanges website.

## 4.2 Compliances and Regulatory Reporting

SEBI and the Stock Exchanges issued various directives/guidelines/circulars to be followed by stock brokers. These include directives on client registration, dealing with clients, issuance of contract note, margin requirements, guideline related to trading software, smooth functioning of pay-in/pay-out, dealing with branches & Authorized Person,

[85] https://static.nseindia.com//s3fs-public/inline-files/FAQs_Additional_Surveillance_Measure.pdf
https://static.nseindia.com//s3fs-public/inline-files/FAQs_Graded_Surveillance_Measure_0.pdf
https://nsearchives.nseindia.com/web/sites/default/files/inline-files/FAQs%20-%20Enhanced%20Surveillance%20Measure%20%28ESM%29_25.7.2025.pdf
https://www.bseindia.com/downloads1/FAQs_on_ASM.pdf
https://www.bseindia.com/downloads1/FAQ_GSM.zip

maintenance & preservation of books of accounts and other documents, trading restrictions, base minimum capital, etc. Other requirements include submission of various reports, disclosures including audit reports along with the annual reports to the Exchanges and payments of fees specified by SEBI from time to time.

The stock broker shall bring to the notice of the relevant Exchange the information about default in payment/delivery and related aspects by a client. In case where defaulting client is a corporate entity/partnership/proprietary firm or any other artificial legal entity, then the name(s) of Director(s)/Promoter(s)/Partner(s)/Proprietor as the case may be, shall also be communicated by the stock broker to the relevant Exchange(s).

In case of any change in the designated director, shareholding, change of control, change in name, amalgamation, merger, demerger, scheme of arrangement, conversion of membership etc., stock broker has to obtain prior/final approval of SEBI/Exchange/Clearing Corporation as per the procedure specified by SEBI/Exchanges in this regards.

Stock brokers adhere to the directives specified in various regulations like SEBI Stock Broker Regulation, SEBI Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market Regulations, SEBI KRA regulation, SEBI (Prevention of Insider Trading) Regulation, Securities Contracts (Regulations) Rules, 1957 , Securities Contracts (Regulation) Act, 1956, Guidelines on Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism (CFT) /Obligations of Securities Market Intermediaries under the Prevention of Money Laundering Act, 2002 and Rules framed there under etc.

#### 4.2.4 Submission of various periodic reports

The stock broker has to provide/disclose/submit various information/ report to Exchanges/Clearing Corporation on periodic (daily, weekly, monthly, quarterly, half-yearly, yearly etc.) basis. These details pertain to day-to-day operation and other compliance. The stock exchanges have prescribed details of these periodic reports to be submitted by the brokers in their compliance calendars. Some of the major reports are given below, for other details participants can refer the compliance calendar of respective Exchanges:

| Sr. No. | Reports | National Stock Exchange[86] | Metropolitan Stock Exchange of India Ltd.[87] | Bombay Stock Exchange[88] |
|---|---|---|---|---|
| 1 | System Audit Report – Half yearly, annual or | Half yearly, annual, or once in 2 years depending on the nature of business carried out by the broker | | |

[86] https://www.nseindia.com/trade/members-compliance-calendar
[87] https://www.msei.in/members/compliance/compliance-calendar
[88] https://www.bseindia.com/static/members/compliancecalendar.aspx

| Sr. No. | Reports | National Stock Exchange[86] | Metropolitan Stock Exchange of India Ltd.[87] | Bombay Stock Exchange[88] |
|---|---|---|---|---|
| | once in 2 years depending on the nature of business carried out by the broker | | | |
| | | Preliminary report, corrective action report, Follow on report within time period specified by Exchange based on the nature of business carried out by broker | | |
| 2 | Annual Returns (Audited Financial Statements) - Annually | By October 31st of every year | By September 30 of every year | By October 31st of every year |
| 3 | Internal Audit Report Half yearly basis | Within 2 months from half year ended March and September | | |
| 4 | Net worth certificate Half yearly basis | Within 2 months from half year ended March and September | | |
| 5 | Net worth certificate in Margin Trading for CM Segment | Within one month from the end of half year | - | Within 1 month from the end of half year |
| 6 | Proof of Insurance cover | Members with validity ending on May 31st: By July 31st<br>Members with any other due date: Within one month from the expiry of validity period | Members with validity ending on May 31st: By July 31st<br>Members with any other due date: Within one month from the expiry of validity period | Within 30 days from the date of expiry of the Insurance policy |
| 8 | Risk Based Supervision | Within 2 months from half year ended March and September | | |
| 9 | Cyber Security Incident reporting | Report within 15 days from the end of quarter. Intimation to SE and SEBI on immediate basis. | | |
| 10 | Cyber Security & Cyber Resilience framework | Preliminary report, corrective action report, Follow on audit report within time period specified by Exchange based on the nature of business carried out by broker | | |
| 11 | Reporting of Artificial Intelligence and Machine Learning applications used by the members. | Within 15 days from the end of quarter | | |
| 13 | Vulnerability Assessment & Penetration Testing (VPAT) | VAPT report submission shall be carried out from September to November of every FY and the final VAPT report shall be submitted within one month from the date of completion of VAPT after approval from Technology Committee. Compliance report submission within 3 months from final VPAT report. | | |

SEBI vide its circular dated February 15, 2023, provided guideline on "Maintenance of a website by stock brokers and depository participants". All stock brokers and DPs are

mandated to maintain a designated website. The URL to the website of a SB/ DP shall be reported to the stock exchanges/ depositories within a week of this circular coming into effect. Any modification in the URL shall be reported to stock exchanges/depositories within 3 days of such changes.

### 4.2.5 Settlement of accounts (funds) & Statement of accounts[89]

SEBI, vide circular no. MIRSD/SE/Cir-19/2009 dated December 03, 2009 and SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016, issued the guideline for settlement of running account of client's funds / securities. The settlement of funds and / or securities shall be done within 1 working day of the pay-out, unless client specifically authorizes the stock broker in writing to maintain a running account. As specified by SEBI, the actual settlement of funds and securities shall be done by the member depending on the mandate of the client and there must be a gap of maximum 90 / 30 days (as per the choice of client viz. Quarterly / Monthly) between two settlements of running account. Vide SEBI circular no. CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019, settlement of running account for securities has been discontinued and therefore, SEBI circulars dated December 03, 2009 and September 26, 2016, are now applicable for settlement of running account of client's "funds" only.

While settling the account, the member should simultaneously send to the client a 'statement of accounts' containing an extract from the client ledger for funds and an extract from the register of securities displaying all receipts/deliveries of funds/securities. The statement should also explain the retention of funds/securities and the details of the pledge, if any. For the purpose of quarterly/monthly settlement trading member may settle across segments of the same Exchange for a particular client.

SEBI has given direction for handling of client securities by trading member/clearing member and also issued following advice with respect to a TM/CM maintaining a running account for client securities and pledging the client securities with Banks/NBFCs.[90]

- With regard to the unpaid securities (i.e., the securities that have not been paid for in full by the clients), such securities shall be transferred to respective client's demat account followed by creation of an auto-pledge (i.e., without any specific instruction from the client) with the reason "unpaid", in favor of a separate account titled –"client unpaid securities pledgee account", which shall be opened by TM/CM.

[89]Refer SEBI circular no. MIRSD/SE/Cir-19/2009 dated December 03, 2009.
[90] SEBI circular CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019 & SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2022/153 dated November 11, 2022.

- After the creation of pledge, a communication (email / SMS) shall be sent by TM/CM informing the client about their funds obligation and also about the right of TM/CM to sell such securities in event of failure by client to fulfill their obligation.
- If the client does not fulfil its funds obligation, TM / CM shall dispose-off such unpaid securities in the market within five trading days after the pay-out. TM/CM, before disposing the securities, shall give an intimation (email / SMS) to the client, one trading day before such sale.
- TM / CM shall invoke the pledge only against the delivery obligation of the client. On invocation, the securities shall be blocked for early pay-in in the client's demat account with a trail being maintained in the TM/CM's client unpaid securities pledgee account.
- In case, such pledge is neither invoked nor released within seven trading days after the pay-out, the pledge on securities shall be auto released and the securities shall be available to the client as free balance without encumbrance.
- Such unpaid securities pledged in client's account shall not be considered for the margin obligations of the client.
- Further, SEBI has restricted broker to pledge client securities to the Banks/NBFCs for raising funds, even with authorization by client as the same would amount to fund-based activity by TM/CM which is in contravention of Rule 8(1)(f) & 8(3)(f) of Securities Contracts (Regulation) Rules, 1957.

SEBI, vide circular no. SEBI/HO/MIRSD/DOP/CIR/P/2020/28 dated February 25, 2020, discontinued title transfer of securities to the demat account of TM for margin purposes and TM shall accept collateral from the clients in the form of securities only by way of 'margin pledge' created in the Depository system.

Further, SEBI vide circular SEBI/HO/MIRSD/MIRSD-PoD1/P/CIR/2023/197dated December 28, 2023, revised guideline for "Settlement of Running Account of Client's Funds lying with Trading Member (TM)" and vide circular SEBI/HO/MIRSD/MIRSD-PoD1/P/CIR/2025/1 dated January 06, 2025, regarding "Measure for ease of doing business -Settlement of Account of Clients who have not traded in the last 30 days". Please refer section 6.2 for further details.

**4.2.6 Sending Account Statements to Clients**

The stock broker shall send a complete `Statement of Accounts' for both funds and securities in respect of each of its clients containing extract of from the client ledger for funds, an extract from the register of securities displaying all receipts and deliveries of securities and a statement explaining the retention of funds and / or securities in such periodicity and format within such time, as may be prescribed by the relevant Exchange,

from time to time, where the trade is executed. The Statement shall also state that the client shall report errors, if any, in the Statement within such time as may be prescribed by the relevant Exchange from time to time where the trade was executed, from the receipt thereof to the Stock broker.

Further, SEBI, vide its letter dated November 27, 2017 has directed that all members shall issue an **Annual Global Statement** to their clients. The statement shall be issued within 30 days from the end of the financial year and shall contain details of all transactions executed by the client in the financial year, details of all charges etc.

### 4.2.7 Risk Based Supervision of Market Intermediaries

Risk Based supervision is a process of assessment of members by the Exchanges on a half yearly basis. It is forward looking and preventive mechanism which aims at assessing the various business areas of the Stock broker, and the associated quality of their management and internal controls, to identify the areas of risks and concern and directing the supervisory focus to these areas.

The Risk Based Supervision model follows four distinct steps:
a. Risk Assessment
b. Assigning Risk & Impact Rating
c. Determining Supervisory Risk Rating Score
d. Supervisory Approach

Under the new model, various market entities would be divided into four groups — very low risk, low risk, medium risk and high risk — and the quantum of supervision and number of inspections would vary as per the risk level of each intermediary. The risk based supervisory model is expected to facilitate a more focused regulatory supervision.

SEBI has formulated a Risk Assessment template in consultation with Stock Exchanges and various Member Associations, which requires most of the inputs from Exchange as well as some from the Members. It is a half yearly process and the timeline for submission of data by broker to Exchange is as under:

| Sr. No. | Period | Due date |
|---|---|---|
| 1. | Half year ending September 20xx | 2 months from the end of period |
| 2. | Financial year ending March 20xx | 2 months from the end of period |

### 4.2.8 Suspicious Transaction Reporting (STR) to Financial Intelligence Unit (FIU)

FIU is a separate intelligence arm under finance ministry. The brokers are expected to report such transactions to FIU through online mechanism provided by FIU.

Intermediaries shall carefully go through all the reporting requirements and formats that are available on the website of FIU – IND under the Section Obligation of Reporting Entity – furnishing information–reporting format.
(https://fiuindia.gov.in/files/downloads/Filing_Information.html). These documents contain detailed directives on the compilation and manner/procedure of submission of the reports to FIU-IND. The Cash Transaction Report (CTR) (wherever applicable) for each month shall be submitted to FIU-IND by 15th of the succeeding month. The Suspicious Transaction Report (STR) shall be submitted within 7 days of arriving at a conclusion that any transaction, whether cash or non-cash, or a series of transactions integrally connected are of suspicious nature. The Principal Officer shall record his reasons for treating any transaction or a series of transactions as suspicious. It shall be ensured that there is no undue delay in arriving at such a conclusion. The Non-Profit Organization Transaction Reports (NTRs) for each month shall be submitted to FIU-IND by 15th of the succeeding month.

### 4.2.9 Facility of voluntary freezing/ blocking of Trading Accounts by Clients[91]

Necessary guidelines with respect to above subject as given following:

- Detailed policy for voluntary freezing/ blocking the online access of the trading account of the client including the following:
    - modes through which a client can request/communicate to the Trading Member for voluntarily blocking the trading accounts;
    - issuing of acknowledgement to the clients on receipt of message;
    - time period within which the request shall be processed and the trading account shall be frozen/blocked.
- Action to be taken by the Trading Member pursuant to the receipt of request for freezing/blocking of the trading account;
- Process for re-enabling the client for trading/transfers; Intimation to be provided by the trading member to the clients w.r.t. introduction of the facility to block the trading accounts.

### 4.2.10 Enhanced obligations and responsibilities on Qualified Stock Brokers (QSBs)[92]

[91] Circular SEBI/HO/MIRSD/POD-1/P/CIR/2024/4 dated January 12, 2024
[92] SEBI Circular SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2023/24 dated February 06, 2023

In order to further strengthen the compliance and monitoring requirements relating to stock brokers and to ensure efficient functioning of securities market, SEBI, has designated certain stock brokers as Qualified Stock Brokers (QSBs). . The stock broker designated as a QSB shall be required to meet enhanced obligations and discharge responsibilities to ensure appropriate governance structure, appropriate risk management policy and processes, Surveillance of client behavior, Integrity of operation, Business Continuity Plan, scalable infrastructure and appropriate technical capacity, framework for orderly winding down, robust cyber security framework, and investor services including online compliant redressal mechanism etc.

Pursuant to the SEBI (Stock Broker) Regulation 2026, SEBI or the Stock Exchanges may designate a stock broker as a qualified stock broker(QSB) This designation accounts for the broker's size, scale of operations and potential impact on investors and the securities market based on the following parameters with appropriate weightages on an annual basis:
(a) the total number of active clients of the stock broker;
(b) the available total assets of clients with the stock broker;
(c) the trading volumes of the stock broker
(d) the end of day margin obligations of all clients of a stock broker
(e) the proprietary trading volumes of the stock broker;

The list of QSBs shall be released jointly by stock exchanges, in consultation with SEBI, on an annual basis. For calculating the values for a particular year, parameters as on December 31st of such year shall be considered. Those QSBs that no longer belong to the list, shall continue to comply with the enhanced obligations and responsibilities for an additional period of 3 financial years or such time, as may be specified by Market Infrastructure Institutions (MIIs), in consultation with SEBI.

## 4.3 Core Settlement Guarantee Fund

SEBI has directed clearing corporation to have a fund called Core SGF (Settlement Guarantee Fund) for each segment of each Recognized Stock Exchange (SE) to guarantee the settlement of trades executed in respective segment of the Stock Exchange.[93] In the event of a clearing member (member) failing to honour settlement commitments, the Core SGF shall be used to fulfill the obligations of that member and complete the settlement without affecting the normal settlement process.

### 4.3.1 Corpus of Core SGF

[93] https://www.sebi.gov.in/sebi_data/attachdocs/1409136206919.pdf

The corpus of the fund should be adequate to meet out all the contingencies arising on account of failure of any member(s). The risk or liability to the fund depends on various factors such as trade volume, delivery percentage, maximum settlement liability of the members, the history of defaults, capital adequacy of the members, the degree of safety measures employed by the CC/SE etc. While deciding on the fair quantum of the corpus of the SGF, the CC should consider the following factors:

- Risk management system in force
- Current and projected volume/turnover to be cleared and settled by the CC on a guaranteed basis.
- Track record of defaults of members (number of defaults, amount in default)

A Minimum Required Corpus (MRC) of the core SGF should be created subject to the following conditions:

i. The MRC shall be fixed for a month.
ii. By 15th of every month, CC shall review and determine the MRC for next month based on the results of daily stress tests of the preceding month.
iii. CC shall also review and determine by 15th of every month the adequacy of contributions made by various contributors and any further contributions to the Core SGF required to be made by various contributors for the next month.
iv. For every day of the preceding month, uncovered loss numbers shall be estimated by the various stress tests for credit risk conducted by the CC for the segment and the highest of such numbers shall be taken as worst case loss number for the day.
v. Average of all the daily worst case loss numbers determined in (iv) above shall be calculated.
vi. The MRC for next month shall be higher of the average arrived at as (v) above and the segment MRC as per previous review.

**4.3.2 Contribution to Core SGF**

Contributions of various contributors to Core SGF of generally in various segment shall be as follows:

a) *Clearing Corporation Contribution:* CC contribution to Core SGF shall be at least 50 percent of the MRC which should be from its own funds. CC contribution to core SGF shall be considered as part of its net worth.
b) *Stock Exchange Contribution:* Stock Exchange contribution to Core SGF shall be at least 25 percent of the MRC (can be against transfer of profits by Exchange as per Regulation 33 of SECC Regulations).
c) *Clearing Member Primary Contribution:* The total contribution from members to core SGF for each segment will not be more than 25% of MRC of the respective segment. No exposure shall be available to CMs on their contribution to core SGF.

The required contributions of individual CMs shall be assessed pro-rata based on the risk they bring to the system. CC shall have the flexibility to collect CM primary contribution either upfront or staggered over a period of time. In case of staggered contribution, the remaining balance shall be met by CC to ensure adequacy of total Core SGF corpus at all times. Such CC contribution shall be available to CC for withdrawal as and when further contributions from CMs are received.

As per SEBI circular no SEBI/HO/MRD/DRM/NP/CIR/P/2016/54 dated May 04, 2016, the clearing member contribution to core SGF shall be met to the extent available from the amount received from Exchange.

d) Any penalties levied by CC shall be credited to Core SGF corpus.
e) Interest on cash contribution to Core SGF shall also accrue to the Core SGF and pro-rata attributed to the contributors in proportion to their cash contribution

SEs are allowed to transfer excess contribution made by them from Core SGF of one CC to the Core SGF of another CC, in inter-operable scenario.

**Further contribution to / Recoupment of Core SGF**[94]

Requisite contributions to Core SGF by various contributors for any month shall be made by the contributors before start of the month. In the event of usage of Core SGF during a calendar month, contributors shall, as per usage of their individual contribution, immediately replenish the Core SGF to MRC. However, such contribution towards replenishment of Core SGF by the members would be restricted to only once during a period of 30 calendar days regardless of the number of defaults during the period. The period of 30 calendar days shall commence from the date of notice of default by Clearing Corporation to market participants. In case there is failure on part of some contributor(s) to replenish its (their) contribution, same shall be immediately met, on a temporary basis during the month, in the following order: (i) By CC (ii) By SE.

CC shall ordinarily accept cash collateral for Core SGF contribution. However, CC may accept CM contribution in the form of bank FDs, Central Government securities or as specified by SEBI from time to time in this regard.

**Management of Core SGF**

The Regulatory Oversight Committee ("ROC") of the CC shall manage the Core SGF. CC may utilize the Core SGF in the event of a failure of member(s) to honour settlement commitment.

### 4.3.3 Default waterfall

[94] SEBI Circular Ref. No. SEBI/HO/MRD2/DCAP/CIR/P/2020/01 Dated January 03, 2020.

In the event of a default, the utilization of the Settlement Guarantee Fund shall generally be in the following order:

a) Monies of defaulting member (including defaulting member's primary contribution to Core SGF(s) and excess monies of defaulter in other segments).
b) Insurance, if any.
c) CC resources (equal to 5% of the segment MRC).
d) Core SGF of the segment in the following order:
    I. Penalties
    II. CC contribution to the extent of at least 25% of the segment MRC
    III. Remaining Core SGF: CC contribution, Stock Exchange contribution and non-defaulting members' primary contribution to Core SGF on pro-rata basis.
e) Proportion of remaining CC resources (excluding CC contribution to core SGFs of other segments and Rs. 100 Crore) equal to ratio of segment MRC to sum of MRCs of all segments. Rs. 100 Crore to be excluded only when remaining CC resources (excluding CC contribution to core SGFs of other segments) are more than Rs. 100 Crore.
f) CC/SE contribution to Core SGFs of other segments (after meeting obligations of those segments) and remaining CC resources to that extent as approved by SEBI.
g) Capped additional contribution by non-defaulting members of the segment.[95]
h) Any remaining loss to be covered by way of pro-rata haircut to pay-outs.

[95] For further details, refer SEBI Circular Ref. No. SEBI/HO/MRD2/DCAP/CIR/P/2020/01 Dated January 03, 2020. The maximum capped additional contribution by non-defaulting members shall be lower of 2 times of their primary contribution to Core SGF or 10% of the Core SGF of the segment on the date of default in case of equity/ debt segments. The maximum capped additional contribution by non-defaulting members shall be lower of 2 times of their primary contribution to Core SGF or 20% of the Core SGF of the segment on the date of default in case of derivatives segment.

**Chapter 4: Sample Questions**

1. Risk containment measures includes which of the following:
   **(a) Checking Margin requirements**
   (b) Checking net worth of the client /investor
   (c) Checking whether the order placed is genuine

2. SPAN method of calculating margin requirement is for trades done _____.
   (a) On the Equities Segment
   **(b) On the Futures and Options Segment**
   (c) On Government Securities

3. State which of the following is true.
   (a) **As per SEBI Stock Broker Regulation 2026, members need to maintain books of accounts for eight years.**
   (b) The sauda book of the register of transactions needs to be maintained by the broker for a period of 2 years.
   (c) Members Contract books showing details of all contracts entered by the broker needs to be maintained for 10 years as per the Rule 15 of SCRR

4. SEBI prescribes brokers/members to send a Global statement to its clients on which periodicity?
   **(a) Annual**
   (b) Quarterly
   (c) Monthly

5. Cash and Cash Equivalent should be at least _____ % of liquid asset?

   (a) 25

   (b) **50**

   (c) 90

6. In case of a _____ movement of the index at any time of the day, the trading will be halted for the remainder of the day.?

   (a) 10%

   (b) 15%

   (c) **20%**

7. In equity segment, _____ & ELM margin is collected upfront basis?

   **(a) VaR margin**

   (b) SPAN margin

   (c) Mark to market margin

8. Once the market wide Open Interest for any scrip exceeds _____ of the Market Wide Position Limit (MWPL) for the scrip, the members/clients shall trade only to decrease their positions through offsetting positions (this is called ban period).?

   (a) 80%

   (b) 90%

   (c) **95%**

# CHAPTER 5: CLEARING PROCESS

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Role of Clearing Corporation
- Role of Clearing Members and Custodians
- Role of Depositories and Depository Participant
- Clearing Process

## 5.1 Introduction

SEBI vide circular dated September 07, 2021, provided guideline for "Introduction of T+1 rolling settlement on an optional basis for cash market segment. Further, all Exchanges, clearing corporations and depositories introduced T+1 rolling settlement in phased manner and all trades in the equities market are now settled in T+1 Settlement Hence the pay-in and pay-out of securities and funds for equities also take place on T+1 day.

General Clearing process in Cash Segment for T+1 rolling settlement

1. At the end of the day's trade (T Day), all details about the trades are sent by the stock Exchanges to the clearing house/corporation.
2. Modification of Custodial Participant (CP) code (T day) upto 4:15 pm.
3. Allocation of "INST" trade on T day as per time specified by clearing corporation.
4. The clearing corporation/house then groups the trades under the various clearing members/custodians and informs them about the transactions of their respective clients.
5. The clearing members/custodians then confirm back institutional/Custodian Participant trades by 7:30 a.m. on T+1 day.
6. The clearing house/corporation then performs multilateral netting and determines the final obligations of all clearing members & custodian for funds and securities on T+1 by 9:00 a.m. and downloaded to them so that they can settle their obligations on the settlement day i.e. T+1.

SEBI vide Circular No. SEBI/HO/MRD/MRD-PoD-3/P/CIR/2024/20dated March 21, 2024 introduced the beta version of T+0 rolling settlement cycle on optional basis in addition to the existing T+1 settlement cycle in Equity Cash Markets, for a limited set of 25 scrips and with a limited number of brokers. SEBI vide circular dated December 10, 2024, increase the number of scrips under optional T+0 settlement and also all stock brokers are allowed to participate in optional T+0 settlement. MIIs and custodians are advised to extend the T+0 settlement facility to Institutional investor as well. Further, SEBI has advised that a

mechanism for the Block Deal window shall be put in place by the Stock Exchanges under the optional T+0 settlement cycle.

## 5.2 Role of the Clearing Corporation

When a trade occurs on the Stock Exchange it is a legal contract between the buyer and seller. If there is a default by either the buyer or the seller the counter party to the trade will have to bear the loss. Clearing Corporation ensure that members meet their fund/security obligations. It acts as a legal counterparty to all trades through the process called novation. Thus Clearing Corporation becomes the buyer to every seller and seller to every buyer. If there is a default in this scenario, Clearing Corporation being counter party, is responsible for ensuring the settlement, thus managing risk and guaranteeing settlement to both the parties.

The major roles of a clearing corporation in financial markets are to ensure the smooth, efficient, and secure settlement of trades while managing systemic risk. The key roles and functions are as follow:

- Central Counterparty (CCP): The clearing corporation becomes the buyer to every seller and the seller to every buyer after a trade is executed.
- Settlement Guarantee: The primary function is to guarantee the final settlement of trades, ensuring that that a trade will be completed as agreed, even if one of the original parties defaults.
- Risk Management: Clearing corporations employ a comprehensive risk management system to mitigate counterparty and systemic risk.
- Clearing and Netting: They verify trade details (price, volume, etc.) and calculate the net obligations of all participants.
- Securities and Funds Transfer: They facilitate the actual transfer of funds (through clearing banks) and securities (through depositories such as NSDL and CDSL) on the pre-defined settlement date.
- Market Efficiency and Transparency: By standardizing the settlement process and providing a structured, guaranteed mechanism for trade completion, clearing corporations enhance overall market liquidity, efficiency, and investor confidence.
- Regulatory Compliance & Reporting: They operate within a stringent regulatory framework and are responsible for reporting data to regulators, thereby enhancing market transparency.

Member Oversight and Discipline: They monitor the activities of their members on a daily basis. If a member violates established rules, the clearing corporation has the authority to investigate, hold disciplinary hearings, impose penalties or even revoke membership.

In a multi-lateral netting scenario, when a default occurs, it is difficult to unwind the trade to find the original counter party who will have to bear the loss. The process of "novation[96]" addresses this risk. To provide such a guarantee, robust risk management practices are put in place including efficient margining system so that in the event of default, Clearing Corporation has sufficient funds from the defaulter to cover the loss. The Clearing Corporation also provides core clearing and settlement services apart from settlement guarantee. The clearing function of the clearing corporation is designed to work out a) what members are due to deliver and b) what members are due to receive on the settlement date. Settlement is a two-way process which involves transfer of funds and securities on the settlement date. Clearing corporation has also devised mechanism to handle various exceptional situations like security shortages, bad delivery, company objections, auction settlement etc. It collects and maintains margins, processes for shortages in funds and securities. It takes help of clearing members, clearing banks, custodians and depositories to settle the trades.

Thus, the clearing agency is the main entity managing the clearing and settlements of transactions and settlement guarantee for transaction done on a Stock Exchange. It interacts with the Stock Exchange, clearing banks, clearing members, custodians and depositories through an electronic connection.

As a central counterparty, the clearing corporation:

- Participates as counterparty in every transaction, which is commonly referred to as a 'counterparty undertaking'.
- Monitors the market and market participants.
- Provides structured procedures, as well as resources for dispute resolution. Buyers and sellers are not forced to take legal action against one another, as the clearing corporation offers independent legal enforcement of contracts.
- Reduces the number of payments due to netting and handles all payments not relating to deliveries on behalf of members.
- Provides possibilities to net deliveries of underlying stocks on a member level compared with netting of payments, which are always netted.
- Provides secure and standardized transaction processing.
- Provides less risk to investors trading on the stock exchanges, as the clearing corporation assumes the role of counterparty agency.
- Calculates and controls the margining mechanism

[96] As per the definition given in the SEBI Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 "novation" means the act of a clearing corporation interposing itself between both parties of every trade, being the legal counterparty to both.

In India, in cash segment there are two clearing corporations, viz., the NSE Clearing Limited (NCL), Indian Clearing Corporation Limited (ICCL).

***Interoperability among Clearing Corporations***[97]

SEBI introduced the concept of Interoperability among Clearing Corporations which necessitates linking of multiple Clearing Corporations. Inter-operability among Clearing Corporation (CC) will enable a Clearing Member to select the Clearing Corporation of its choice to clear and settle trades executed in multiple exchanges. It allows market participants to consolidate their clearing and settlement functions at a single Clearing Corporation, irrespective of the stock exchange on which the trade is executed. It is expected that the interoperability among Clearing Corporations would lead to efficient allocation of capital for the market participants, thereby saving on costs as well as provide better execution of trades.

The interoperability framework shall be applicable to all the recognised clearing corporations excluding those operating in International Financial Services Centre (IFSC) and all the products available for trading on stock exchanges, except commodity derivatives and Tri-party repo. The order collection mechanism/schemes such as Offer for Sale, Mutual Funds Service Scheme, Buy back/Tender Offer, Non Competitive bidding, Primary bidding of SGB etc. are not covered under the facility of interoperability among CC. The Securities lending and Borrowing Scheme of Clearing Corporation is also kept outside Inter-operability.

Every Clearing Member (CM) shall be required to designate a Clearing Corporation (CC) for each business segment covering all its Trading Members (TMs) in that business segment. A CM may maintain membership with more than one CC. However, the CM can be active with only one CC per business segment at any point of time. A CM may choose different CC as its designated CC for different business segments since the choice of designated CC is made at the CM-Segment level. Custodians shall have the facility to specify a designated CC separately for each of their CPs, as the choice of designated CC for a Custodian is determined at Custodian-CP Segment level.

The recognised clearing corporations shall establish peer-to-peer link for ensuring interoperability. A clearing corporation shall maintain special arrangements with another clearing corporation and shall not be subjected to normal participant (membership) rules. Risk management between the clearing corporations shall be based on a bilaterally approved framework and shall ensure coverage of inter-clearing corporation exposures. Clearing corporations shall exchange margins and other financial resources on a reciprocal basis based on mutually agreed margining models.

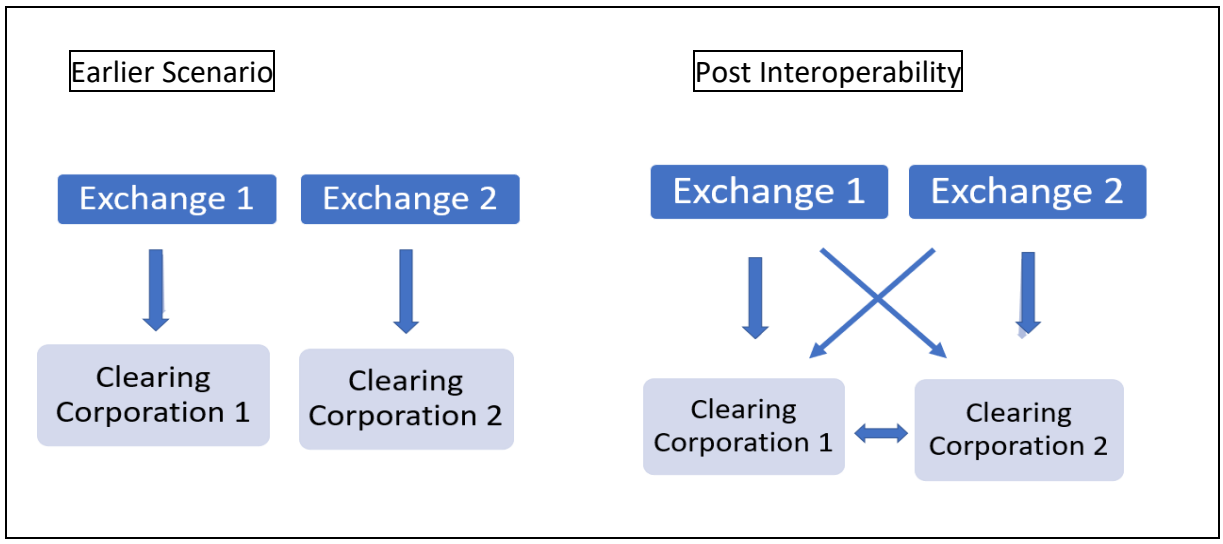
[97] SEBI circular CIR/MRD/DRMNP/CIR/P/2018/145 dated November 27, 2018

To manage the inter-Clearing Corporation exposure in the peer-to-peer link, Clearing Corporations shall maintain sufficient collateral with each other so that any default by one Clearing Corporation, in an interoperable arrangement, would be covered without financial loss to the other non-defaulting Clearing Corporation. The inter- Clearing Corporation collateral shall comprise two components, viz. (a) Margins as per the existing Risk Management Framework (initial margin, extreme loss margin, calendar spread margin, etc.) prescribed by SEBI; and (b) Additional capital, to be determined by each Clearing Corporation, based on the credit risk from the linked Clearing Corporation, on which no exposure shall be granted to the linked Clearing Corporation.

Following are some of the benefits of Interoperability among clearing corporations

- Choice to participants to choose the clearing corporation
- Better capital utilization
- Reduce trading disruption
- Reduce aggregate exposure
- Reduced operational complexity
- Enhanced market competition and lower cost of clearing
- Execution risk can be decoupled from settlement risk as there can be an 'arm's length' relationship between the exchange and adjunct clearing corporation.

Pictorial representation of Interoperability among clearing corporations




## 5.3 Clearing Banks and their function

Clearing Bank(s) acts as an important intermediary between a clearing member(s) and the clearing corporation. Every clearing member needs to maintain an account with any of the empanelled clearing banks at the designated clearing bank branches. The clearing accounts

are to be used exclusively for clearing & settlement operations. It's the function of the clearing members to ensure that the funds are available in his account with clearing bank on the day of pay-in to meet the funds obligations. In case of a pay-out clearing member receives the amount on pay-out day.

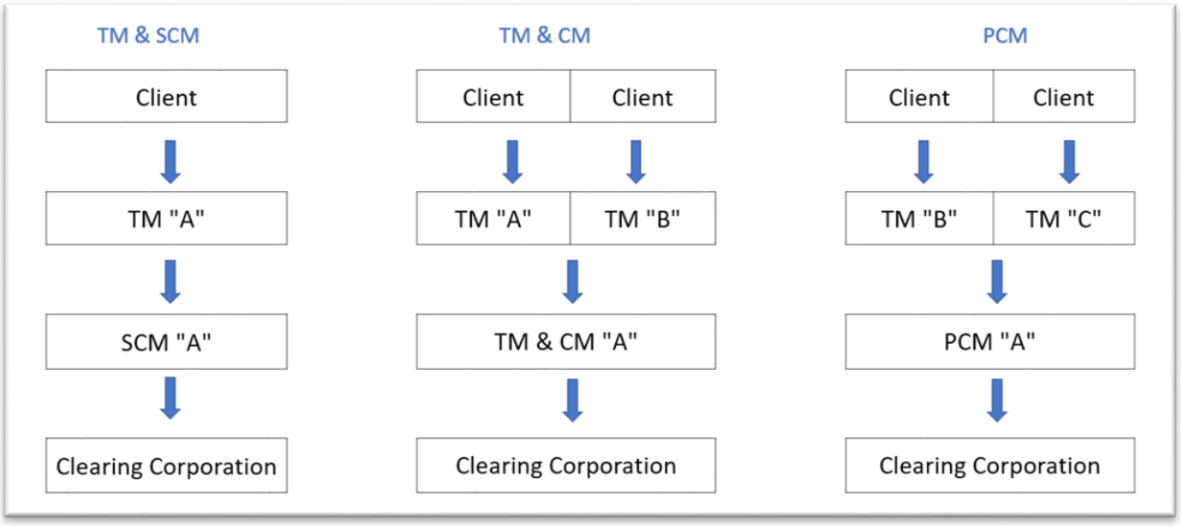
All transactions of pay-in/pay-out of funds are carried out by these clearing banks. The pay-in obligation details are passed on to the clearing banks by clearing corporation, who then debit the clearing member account and based on pay-out instruction from clearing corporation the clearing bank will credit the receiving member clearing account.

The clearing banks are required to provide the minimum services as specified by Clearing Corporation to clearing members.

## 5.4 Clearing members and Custodians

As already discussed in chapter 2 of this workbook, there are three types of clearing members who help in clearing of trades namely, professional clearing member (PCM), trading cum clearing member (TCM) and trading cum self-clearing member (SCM). The clearing members need to take membership of the clearing corporation/s. They then get a unique member ID number from the clearing corporation. Custodians act as clearing members but not trading members. They settle trades in cash segment on behalf of their institutional clients which are executed through other trading members.

Pictorial representation of various kind of clearing member is given below:




Clearing Members and Custodian handle the responsibility of clearing and settlement of all deals executed by Trading Members, who clear and settle such deals through them. Clearing Members and Custodian perform the following important functions:

- Clearing: Computing obligations of all his trading members i.e., determining positions to settle.
- Settlement: Performing actual settlement.
- Risk Management: Setting limits based on upfront deposits / margins for each trading member/client and monitoring positions on a continuous basis.
- Confirmation of custodian participant trade.

To perform its clearing and settlement functions, it is mandatory for clearing members to open demat accounts with both the depositories, i.e., the Central Depository Services Limited (CDSL) and the National Securities Depositories Limited (NSDL) through depository participant. These accounts are known as clearing member settlement pool account. It should be noted that unlike the usual demat accounts, the clearing member does not get any ownership or beneficiary rights over the shares held in these accounts. The benefits related to shares are received in the pool account, from where they are distributed to the beneficiaries. A pool account is a settlement account of broker / exchange member from where broker deliver securities to exchange's clearing corporation against pay-in obligation and receive pay-out of securities from clearing corporation. Client can transfer share directly in members pool account.

It is mandatory for clearing member to open separate and distinct clearing bank account with the designated clearing bank. This account is used for clearing and settlement operation i.e. for settlement of fund obligation, payment of margins, release and enhancement of collateral, EPI of funds, penal charges etc. Clearing members shall irrevocably authorize to Clearing Bank for operation of clearing account, the clearing banks to access their clearing accounts for debiting and crediting their clearing accounts as per the instructions of the Clearing Corporation, reporting of balances and other information as may be required by the Clearing Corporation from time to time. Clearing member can deposit fund in these accounts in any form but withdraw funds from these accounts only in self-name. Clearing member can maintain and operate additional clearing account with designated clearing bank for the purpose of enhancement of collateral in the form of cash and providing early pay-in of funds.

The clearing corporation provides details of all transaction of members and their clients which are linked to its clearing member. Wherever applicable, the clearing member shall confirm the transaction (about the genuineness of the transactions). In cash market, trades which are allocated for settlement by Custodians are indicated with a Custodian Participant (CP) code and the same is subject to confirmation by the respective Custodian. Once this is done, the clearing agency then determines the net obligations of the clearing members/custodian through multilateral netting.

## 5.5 Depositories & Depository Participants

A "Depository" is an entity facilitating holding securities in electronic form and enables transfer of securities by book entry. The main objective of depository is to provide maintenance of ownership or transfer records of securities in an electronic book entry form resulting in paper-less trading rather than paper-based trading and to ensure transferability of securities with speed, accuracy and safety. In clearing and settlement process, the depositories facilitate transfer of securities from one account to another at the instruction of the account holder.

The Depository provides its services to clients through its agents called depository participants (DPs). For trading in Cash Market, it is mandatory for buyer and seller to open demat (beneficiary) account with the depository participant in either of the depositories. In the depository system both transferor and transferee have to give instructions to its depository participants (DPs) for delivering (transferring out) and receiving of securities. . The transferee has to submit Receipt Instruction to received securities into his account. However, for the convenience of investor transferee can give 'Standing Instructions' (SI) to its DP for receiving in securities. If 'SI' is not given, then the transferee has to give separate instructions each time for receiving the securities.

Transfer of securities from one account to another may be done for any of the following purposes:

a. Transfer due to a transaction done on a person-to-person basis i.e. 'off-market'[98] transaction.
b. Transfer arising out of a transaction done on a recognised Stock Exchange.
c. Transfer arising out of transmission of securities and account closure.

A beneficiary account can be debited only if the beneficial owner has given 'Delivery Instruction Slip' (DIS) in the prescribed form. The DIS for an off-market trade or for a market trade has to be clearly indicated in the form by marking appropriately. The form should be complete in all respects. All the holder(s) of the account have to sign the form. If the debit has to be effected on a particular date in future, account holder may mention such date in the space provided for 'execution date' in the form. Further, both the depositories also facilitate for electronic delivery instruction slip facility to clients of DPs over internet. SEBI has introduced concept of 'Demat Debit and Pledge Instruction'(DDPI), under which the clients shall explicitly agree to authorize the stock broker/stock broker and depository participant to access their BO account for the limited purpose of meeting pay-in obligations for settlement of trades executed by them. The DDPI shall serve the same purpose of PoA

[98] A trade which is not done on a recognised stock exchange is known as off-market trade.

and significantly mitigate the misuse of PoA. Trades done on the Exchange is one that is settled through participation of a Clearing Corporation. In the depository environment, the securities move through an account transfer. It is explained below:

- After the trade is executed by the broker on the stock exchange, the seller gives delivery instructions to his DP to move securities from his account to his broker's pool account. Stockbrokers can use a client's Demat Debit and Pledge Instruction (DDPI) or a valid, existing Power of Attorney (POA) to transfer securities from the client's beneficial owner (BO) account to the broker's pool account for settlement obligations.
- Securities are transferred from broker's pool account to Clearing Agency settlement pool account on the basis of a delivery out instruction. Before the actual transfer of securities takes place, a validation process will be performed between CCs and Depositories.
- On pay-out, based on clearing corporation pay-out instruction, depositories will move securities from Clearing Corporation pool account to the buying broker's pool account. SEBI vide circular dated June 05, 2024, has decided the securities for pay-out shall be credited directly to the respective client's demat account by the CCs. The direct payout of securities, shall not be applicable to clients having arrangements with custodians registered with SEBI for clearing and settlement of trades.
- Buying broker gives instructions and securities move to the buyer's beneficiary account.

## 5.6 Clearing Process

The clearing function of the clearing corporation is designed to work out a) what members are due to deliver and b) what members are due to receive on the settlement date.

In the clearing corporation this is done by a process called multilateral netting. This process is performed by the clearing agency (clearing corporation/clearing house). The clearing agency guarantees that all contracts which are traded will be honoured.

Clearing is the process of determination of obligations, after which the obligations are discharged by settlement. A multilateral netting procedure is adopted to determine the net settlement obligations (delivery/receipt positions) of the clearing members. Accordingly, a clearing member would have either pay-in or pay-out obligations for funds and securities separately. Settlement is a two-way process which involves transfer of funds and securities on the settlement date. Clearing corporation also devised mechanism to handle various exceptional situations like security shortages, bad delivery, company objections, auction settlement etc.

For certain transactions / securities the settlement is done on Gross basis i.e. trade for trade basis and there is no netting of transactions.

***The following is the summary Clearing and Settlement process in India for cash market/equities:***

- Trade details are available to Clearing Corporation from the Exchange.
- After the custodial confirmation, Clearing Corporation determines obligations.
- Download of obligation and pay-in advice of funds/securities by Clearing Corporation to clearing members and custodians.
- The delivering member shall complete delivery instructions for transfer of securities to CM Clearing Pool Account on settlement day before time specified by clearing corporation.
- The paying member shall ensure that clear funds are available in his clearing bank settlement account day before time specified by clearing corporation.
- Pay-in of securities: Clearing Corporation advises depository to debit pool account of custodians/Clearing members and credit its (Clearing Corporation's) settlement pool account and depository does the same.
- Pay-in of funds: Clearing Corporation advises Clearing Banks to debit account of Custodians/Clearing members and credit its account and clearing bank does the same.
- Pay-out of securities: As already mentioned in the earlier section, SEBI has introduced direct pay-out of securities to the respective client's demat account by the CCs. The direct pay-out of securities, shall not be applicable to clients having arrangements with custodians registered with SEBI for clearing and settlement of trades.
- Pay-out of funds: Clearing Corporation advises Clearing Banks to credit account of custodians/ Clearing members and debit its account and clearing bank does the same.
  **Note:** Clearing members for buy order and sell order are different and Clearing Corporation acts as a link here.

**5.6.1 Settlement of Institutional Transaction in Cash Segment:**

- Institutional Transaction means transaction done on behalf of institutional investors. Institutional investors shall include Category I and II Foreign Portfolio Investors (FPI) (who are not corporate bodies, family offices and individual) as per SEBI FPI regulations 2019, Mutual Funds registered with SEBI, Public Financial Institutions Banks, Insurance Companies, Pension Funds.
- It is mandatory for institutions to settle their trades through Custodian. Institutions through custodian applied to the cleating corporation for the Custodial Participant (CP) Code. It is mandatory to enter CP code at the time of order entry. CP code allows institutions to trade with multiple broker and settle deals with single custodian.
- It was mandated that all the institutional trades executed on stock exchanges would be processed through the Straight Through Processing (STP) system. A contract note in electronic form in the format prescribed by SEBI shall be issued by the broker & sent to

custodian and/or to the institutional investor. It is mandatory for all institutional investor to follow transaction work flow specified by SEBI vide circular dated June 10, 2004.

- Trading member may also enter "INST" code in the custodial participant code at the time of entering orders on behalf of the institutional clients. Members are required to allocate the INST trades only to the above mentioned categories within the time specified by the Exchanges/Clearing Corporations.
- For FPIs that are corporate bodies, individuals or family, INST facility is not be available in the similar manner as of the non-institutional CP codes. For FPIs, allocation for INST trade are allowed only to related FPIs. Members can provide details of related FPIs to the Clearing Corporation.
- No institutional investor shall be allowed to do day trading i.e. square of their transaction intra-day. All transactions would be grossed for institutional investors at the custodian level and the institutional investor should be required to fulfil their obligation on gross basis. The custodian, however, continue to settle their deliveries on net basis with the stock exchanges.
- Institutional investors shall be permitted to short sell. However naked short selling shall not be permitted in the Indian stock market, and accordingly all investors would be required to mandatorily honour their obligation of delivering the securities at the time of settlement.
- The institutional transactions does not attract margin on upfront basis. The margin is applicable on T+1 day subsequent to confirmation of trade by custodian. Trades of category II FPIs who are corporate bodies, individuals or family offices and domestic entities who may choose to settle trades through Custodian shall be margined on an upfront basis as per the margining framework of non-institutional trades.
- In the event of rejection of institutional trades by custodian the trade will be settled through Delivery Versus Payment (DVP) basis. Such trades will be subjected to penalties as may be imposed by SEs/CCs.

The general time line followed for the custodian settled trade for institutional clients is as follows for T+1 rolling settlement:

- T is trade date by broker
- Modification of CP code on T day upto 4:15 pm
- Obligation Transfer Request (OTR) for INST trades on T day upto 8:00 pm
- Custodial Confirmation on T+1 day upto 7:30 am
- Final obligation to custodian on T+1 upto 9:00 am.
- Payment of margins, if any or early pay-in of securities and/ or funds as per regular procedure.

- On T+1 funds / Securities pay-in (around 11:00 am) and pay-out (Funds pay-out at 1:30 pm & securities pay-out by 3:30 pm) between clearing corporation and custodian.
- Settlement of trade processing within 24 hours of receipts of cash/securities..

There is also a provision for non-institutional investors to have a Custodial Participant (CP) code in the Capital Market (CM) segment. If they choose to use a professional clearing member/custodian, trades confirmed by the clearing members shall form part of that clearing member's obligation. The clearing members shall be responsible for all obligations arising from such trades including the payment of margins, penalties, any other levies, and settlement of obligations.

### 5.6.2 Block Mechanism in demat account of clients undertaking sale transactions[99]

- When the client intends to make a sale transaction, shares will be blocked in the demat account of the client in favour of Clearing Corporation. If sale transaction is not executed, shares shall continue to remain in the client's demat account and will be unblocked at the end of the T day. Thus, this mechanism will do away with the movement of shares from client's demat account for early pay-in and back to client's demat account if trade is not executed.
- The securities lying in client's demat account will be blocked either by client himself using depository's online system or e-DIS mandate or through depository participant based on physical DIS given by client or Power of Attorney (POA) holder.
- Depositories may keep block on the securities in client's demat account in respect of Intra or Inter depository transfer instruction till pay-in day. The blocked securities will be transferred only after checking against the client level net delivery obligation received from CCs.
- Depositories will provide the details of transfer instructions viz., UCC, TM ID, Exchange ID etc. to CCs for clients to avail EPI benefit.
- CC will match the client level net obligations with the Block details provided by depositories and CC will provide EPI benefit to client if the client level net obligation exists for that client.
- After receiving client level net obligations on T day from CCs, depositories will match the Intra or Inter depository transfer instruction details with CC obligation details based on UCC, TM ID, CM ID, Exchange ID, etc.

[99]Circular SEBI/HO/MIRSD/DOP/P/CIR/2021/595 dated July 16,2021, Circular SEBI/HO/MIRSD/DOP/P/CIR/2022/109 dated August 18, 2022 and Circular SEBI/HO/MIRSD/DoP/P/CIR/2022/143 dated October 27, 2022

- In case of unmatched orders, CCs shall upload cancellation of Block instruction on T day so that securities are unblocked and become free in client's demat account on T day itself.
- Broker or client shall not be allowed to unblock securities if EPI benefit is provided by CC to client for the same.
- The facility of block mechanism shall be mandatory for all Early Pay-In transactions.
- The block mechanism shall not be applicable to clients having arrangements with custodians registered with SEBI for clearing and settlement of trades.

### 5.6.3 Validation of Instructions for Pay-In of Securities from Client demat account to Member Pool Account against obligations received from the Clearing Corporations[100]

In order to further mitigate the risk for clients' securities, particularly those given towards delivery/settlement obligations, instructions for pay-in of securities from client demat account to TM pool account against obligations received from the CCs shall be validated. The process shall be followed as under:

- Depositories, prior to executing actual transfer of the securities for Pay-In from client demat account to TM Pool account , shall validate the transfer instruction received through any of the available channels for the purpose of Pay-in, i.e. either initiated by clients themselves or by the Power of Attorney ("POA") / Demat Debit and Pledge Instruction ("DDPI") holder against the client -wise net delivery obligation received from CCs.
- Depositories receive the debit instruction for the purpose of Pay-In, given either by client himself using depository's online system or electronic Delivery Instruction Slip (eDIS) mandate or through depository participant based on physical DIS / digitally signed DIS given by client or POA / DDPI holder.
- CCs shall provide client - wise net delivery obligations on T day to the depositories.
- Based on the obligation data provided by CCs, Depositories shall validate the depository transfer instruction details with CC obligation details based on UCC, TM ID, CM ID, Exchange ID , ISIN, quantity, settlement details etc. Matched Instruction.
- In case of matching of all details like UCC ,TM ID, CM ID, ISIN, quantity, settlement details etc. of the transfer instruction with the obligation data, the instruction shall be carried out by the Depositories and such securities will be debited from client's demat account and credited to linked TM Pool account on or before the settlement day. Unmatched Instruction.
- In case of discrepancies in details like UCC, TM ID, CM ID, ISIN etc., between instruction and obligation, such transfer instructions will be rejected by the depositories.

[100] SEBI circular: SEBI/HO/MIRSD/DoP/P/CIR/2022/119 dated September19, 2022

- If the quantity in instruction is less than the obligation provided by CC, then the instruction will be carried out by the depositories.
- If the quantity in instruction is more than the obligation provided by CC, then the instruction will be partially processed by the depositories (i.e., upto the matching obligation quantity).
- This process shall not be applicable to clients having arrangements with custodians registered with SEBI for clearing and settlement of trades.

### 5.6.4 Clearing Process for Derivatives

The clearing mechanism in derivatives essentially involves working out open positions[101] and obligations of clearing members. This position is considered for exposure and daily margin purposes. The open positions of clearing members are arrived at by aggregating the open positions of all the brokers/trading members and all custodial participants[102] clearing through them. A trading member's open position is arrived at by summing up his proprietary and client's open positions.[103] Proprietary positions are calculated on net basis (buy - sell) for each contract[104]. Clients' positions are arrived at by summing together net (buy - sell) positions of each individual client. Please note that positions are only netted for each client at contract level and not netted across clients and are rather added up across clients. A TM's open position is the sum of proprietary open position, client open long position and client open short position.

For example: A clearing member 'A' with two TMs clearing through him 'PQR' and 'XYZ'.

| | | Proprietary Position | | | Client 1 | | | Client 2 | | | Net Member |
|---|---|---|---|---|---|---|---|---|---|---|---|
| TM | Security | Buy Qty | Sell Qty | Net Qty | Buy Qty | Sell Qty | Net Qty | Buy Qty | Sell Qty | Net Qty | |
| PQR | INDEX May Future contract | 5000 | 3000 | 2000 | 3000 | 2000 | 1000 | 3000 | 1000 | 2000 | Long 5000 |
| XYZ | INDEX May Future contract | 1000 | 2000 | (1000) | 2000 | 1000 | 1000 | 3000 | 4000 | (1000) | Long 1000 Short 2000 |

[101] Outstanding/ unsettled either long (buy) or short (sell) position in various derivative contracts is called "Open Position.
[102] Custodial participants (CP) are those clients who are eligible for trading through trading members and clearing and settling deals through clearing members. Such CP registered with clearing corporation through Clearing Members.
[103] While entering orders on the trading system, TMs are required to identify the orders, whether proprietary or client through the pro /cli indicator in the order entry screen.
[104] The contract will be distinguished based on futures and option, underlying instrument, expiry date, option type, strike price.

Clearing member A's open position for Index May future contract is:

| Member | Long Position | Short Position |
|---|---|---|
| PQR | 5000 | 0 |
| XYZ | 1000 | 2000 |
| Total for A | 6000 | 2000 |

All derivatives contracts whether index futures, stock futures, index options, stock options, currency futures & options or interest rate futures & option are settled either through cash settlement or physical settlement. The settlement process would be discussed in chapter 6 of this workbook.

**Custodial Participant Trade**

Custodial participants are constituents who are eligible to trade through trading members and clear and settle their deals through clearing members. Such custodial participants shall register themselves with the Clearing Corporation through their clearing members. Clearing members of the custodial participants shall confirm trades executed on behalf of the custodial participants, as specified by the Exchange/Clearing Corporation from time to time. All trades confirmed by the clearing members shall form part of the obligations of the concerned clearing members who shall be responsible for all obligations arising from such trades including the payment of margins, penalties, any other levies, and settlement of obligations.

**Net Settlement of Cash segment and Futures & Options (F&O) segment upon expiry of stock derivatives[105]**

With a view to provide better alignment of cash and derivatives segment, mitigation of price risk and bringing in netting efficiencies for market participants, SEBI has introduced the mechanism of Net Settlement of cash segment and F&O segment upon expiry of stock derivatives. The details of the same as under:

- The obligations arising out of cash segment settlement and physical settlement of F&O segment, upon expiry of stock derivatives, shall be settled on net basis.
- The benefit of netting (merged settlements) shall be available to investors whose trading member (TM) clears trades in F&O segment and cash segment through the same clearing member (CM) i.e. benefit of netting shall be available to investors who trade and clear through the same TM-CM combination in Cash and F&O segment. However, investors whose TM clears trades through different CM /Clearing Corporation (CC) will not be able to avail the benefit of netting.

[105] SEBI circular: SEBI/HO/MRD2_DCAP/P/CIR/2022/165 dated November 30, 2022.

- Netting of settlement obligations of cash segment and physical settlement of F&O segment shall not be available for the institutional investors (including all categories of FPIs)since the extant regulatory framework specifies that all transactions by the institutional investors (including all categories of Foreign Portfolio Investors) in cash market should be backed by delivery.
- Under the Net Settlement mechanism, netting of delivery obligations shall be only for the purpose of settlement. Therefore, Securities Transaction Tax (STT) and Stamp Duty shall continue to be computed, levied and reported on a segment wise level.

An illustration highlighting the benefit of Net Settlement is placed in Box 5.1.

**Box 5.1: Benefit of net settlement between Cash & F&O**

Suppose an investor has following positions:

1. Long In The Money (ITM) put option of strike price Rs.110, with underlying settlement price as Rs.100.

2. A cash market trade done on the expiry day, with security purchased at Rs. 101.

In this case, under the existing mechanism of separate settlements of cash and F&O segments, the settlement would happen in the following manner:

1.The investor will make funds pay-in of Rs. 101 in cash segment.

2.The investor will receive pay-out of the stock in cash segment.

3.The investor will deliver the stock in F&O settlement.

4.The investor will receive Rs. 110.

Further, under the existing mechanism, margin would be applicable on delivery obligations in cash segment and F&O segment separately.

Under the Net Settlement mechanism, there would be no need for the investor to arrange for funds of Rs. 101, i.e., the investor would have a net pay-out of Rs. 9 and would not have any requirement of securities pay-in or pay-out. Further, there would be no margin requirement, after expiry, since there would be only cash receivable and no delivery obligation.

### 5.6.5 Balancing / Netting of Clients accounts within the broker's firm

The stock brokers are allowed to net the clients account within the firm. At the end of the day, the position of each client is netted against all his transactions and the final pay-in/pay-out of securities/funds is carried out through clearing banks and depository participants.

### 5.6.6 Broker netting with Clearing Corporation

Every day, the clearing corporation sends the clearing member a list of all trading transactions made by him and his clients for the day. After this, clearing is performed by multilateral netting. Then the members are informed by the clearing corporation of the amount/securities to be received/paid by them to the other members. An example of multilateral netting is given below for better understanding.

Say trade takes place between 3 parties on Security ABC on a particular trade day called T. The parties involved are Broker 'X', Broker 'Y' and Broker 'Z'. The following are the trades that took place on the security ABC:

| **Trade** | **Buyer** | **Seller** | **Quantity of Shares** | **Price** | **Trade Value** |
|---|---|---|---|---|---|
| 1 | X | Y | 200 | 10 | 2000 |
| 2 | Y | Z | 50 | 10.50 | 525 |
| 3 | X | Z | 100 | 10.50 | 1050 |
| 4 | Y | X | 300 | 11 | 3300 |

**Broker X**

| Buy | Sell | Price | Traded Value |
|---|---|---|---|
| 200 | | -10 | -2000 |
| 100 | | -10.5 | -1050 |
| | 300 | 11 | 3300 |
| **300** | **300** | | **250** |

Net Quantity to deliver / receive = 300-300 = 0
Net Value to receive pay = 250 (to receive)

**Broker Y**

| Buy | Sell | Price | Traded Value |
|---|---|---|---|
| | 200 | 10 | 2000 |
| 50 | | -10.5 | -525 |
| 300 | | 11 | -3300 |
| **350** | **200** | | **-1825** |

Net Quantity to deliver / receive = 350-200 = 150 (to receive)
Net Value to receive pay = -1825 (to pay)

**Broker Z**

| Buy | Sell | Price | Traded Value |
|---|---|---|---|
| | 50 | 10.5 | 525 |
| | 100 | 10.5 | 1050 |
| **0** | **150** | | **1575** |

Net Quantity to deliver / receive = 0-150 = -150 (to deliver)
Net Value to receive pay =1575 (to receive)

| | Quantity to Deliver | Quantity to receive | Funds to Pay | Funds to receive |
|---|---|---|---|---|
| Broker X | 0 | 0 | 0 | 250 |
| Broker Y | 0 | 150 | 1825 | 0 |
| Broker Z | 150 | 0 | 0 | 1575 |
| **Total** | **150** | **150** | **1825** | **1825** |

## 5.7 Optional T+0 rolling settlement cycle

Some of the operational details for T+0 settlement based on SEBI circular and FAQ of the Exchanges and Clearing corporation are given below:

- Eligible Investors: All investors are eligible to participate in the segment for T+0 settlement cycle, if they are able to meet the timelines, process and risk requirements as prescribed by the MIIs.
- Trade Timings: One continuous trading session from 09:15 AM to 1:30 PM
- Price Band: The price in the T+0 segment will operate with a price band of +100 basis points from the price in the regular T+1 market. This band will be re-calibrated after every 50 basis points movement in the underlying T+1 market
- Netting of Obligations: There shall be no netting in pay-in and pay-out obligations between T+1 and T+0 settlement cycle.
- Pre-Open, Special Pre-Open, Auction, Periodic call auction and post close session are not applicable under T+0 settlement.
- Block session window (only 1) will be available to T+0 settlement.
- Pay-in of securities shall only be in the form of early pay-in by way of block mechanism.
- Auction shall not be conducted in case of securities shortage. Security shortages shall be directly closed out at 10% above the highest price of the day across all exchanges for T+0 market.
- No trading for T+0 settlement on Ex-date of securities, settlement holidays etc.
- T+0 prices are not considered for index computation and settlement price computation.
- For non-custodial transaction pay-in timings is around 1:45 pm.

For additional information, candidate may refer SEBI circulars, Exchanges, CCs and Depositories FAQ related to T+0 settlement.

**Chapter 5: Sample Questions**

1. The process of original trade being cancelled and the clearing agency taking over as counterparty to all trades is called _____
   (a) Execution
   **(b) Novation**
   (c) Determination
   (d) Guaranteeing

2. What kind of accounts is used to receive shares from selling clients and to send shares to buying clients?
   (a) Delivery
   **(b) Pool**
   (c) Receipt
   (d) Common

3. Which procedure is adopted to determine the net settlement obligations (delivery/receipt positions) of the clearing members?
   **(a) Multilateral Netting**
   (b) Novation
   (c) Auto Netting
   (d) Pay-in

4. Which concept allows market participants to consolidate their clearing and settlement functions at a single Clearing Corporation, irrespective of the stock exchange on which the trade is executed?
   **(a) Interoperability**
   (b) Interconnectivity
   (c) Novation

5. Following are the major role of clearing corporations?

   (a) Provide trading platform

   **(b) Clearing and settlement**

   (c) Creation of new security

6. In interoperability of clearing corporation, clearing member can be active with _____ clearing corporation per business segment at any point of time?

   **(a) one**

   (b) two

   (c) no restriction

7. The price in the T+0 segment will operate with a price band of +/- _____ basis points from the price in the regular T+1 market?

   **(a) 100**

   (b) 200

   (c) 500

8. The seller of securities gives instructions to the _____ to transfer securities to the pool account of the broker.

   (a) Clearing Bank

   (b) Clearing Corporation

   (d) **Depository Participant**

# CHAPTER 6: SETTLEMENT PROCESS

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Determining of Settlement of obligations
- Settlement of Funds
- Settlement of Securities
- Corporate Actions adjustment
- Methodology for adjustment in Equity F&O
- Auction of securities

## 6.1 Introduction

In the Indian equities market currently, all cash market segment settlements are on T+1 day rolling basis. From a settlement cycle taking a week, the Exchanges have now moved to a faster and efficient mode of settling trades within T+1 Days. For instance, trades taking place on Monday are settled on Tuesday, Tuesday's trades settled on Wednesday and so on. Hence, a settlement cycle is the period within which the settlement is made. For arriving at the settlement day, all intervening holidays -- bank holidays, Exchange/clearing corporation holidays, Saturdays and Sundays are excluded. SEBI has also introduced the beta version of T+0 rolling settlement cycle on optional basis in addition to the existing T+1 settlement cycle in Equity Cash Markets.

In case of exchange-traded equity derivatives contracts in India, some of the derivatives contracts (such as those based on the Indices) are cash-settled and some of the contracts (such as those based on individual securities) are physically settled. Cash settlement is a settlement method where upon expiration or exercise of the derivatives contract, the counterparties to the contract settle their position through exchange of the price differentials and do not deliver the actual (physical) underlying asset. In case of Physical settlement, the counterparties settle their position through the exchange of the underlying security.

The daily & final settlement of derivative trades is done on T+1 working day basis except for final settlement of currency derivatives segment, where final settlement take place on a T+2 basis. The funds pay-in and pay-out of daily mark to market settlement, final settlement of futures contracts which are cash settled, premium settlement and the final exercise settlements of options contracts which are cash settled are typically effected before start of market hours on the next day i.e. around 8:30 a.m. The Clearing Corporations announces the settlement schedule for various segments/products on a periodic basis.

Typical activity schedule for T+1 Rolling Settlement in Cash Market:

| Sr. No | Day | Time | Description of activity |
|---|---|---|---|
| 1 | T | | Trade Day |
| 2 | T+1 | By 7:30 AM | Completion of custodial confirmation of trades to CC/CH. |
| | | By 9:00 AM | Completion of process and download obligation files to brokers/ custodians by the CC/CH. |
| 3 | T+1 | Upto 11.00 am | Pay-in of Securities and Funds |
| | | | Valuation debit in case of non-delivery of securities |
| | | By 1.30 pm | Pay-out of funds. |
| | | By 3.30 pm | Pay-out of Securities** |
| 4 | T+1 | | Auction Session for T day trade under T+1 settlement cycle |
| 5 | T+2 | | Pay-in (this is generally done by 8:00 am) and pay-out. |

** SEBI vide circular reference number SEBI/HO/MIRSD/MIRSDPoD1/P/CIR/2024/75 dated June 5, 2024, has mandated that the pay-out of securities be credited directly to the client account by the Clearing Corporations (CC).

As a consequence of the above, the timing of the payout of securities shall be revised from 1:30 PM to 3:30 PM. Thus, as a result of Direct Payout, the securities shall be credited to the clients' demat account on the same settlement day instead of one working day from the receipt of pay-out from the Clearing Corporation.

The securities direct pay-out shall not be applicable to clients having arrangements with custodians registered with SEBI for clearing and settlement of trades.

### 6.1.1 Settlement of Transaction in case of Holidays

The following guidelines is followed with a view to enable smooth settlement process and enable CCs meet their obligations in case of holidays:

- The CCs shall clear and settle the trades on a sequential basis i.e., the pay-in and the pay-out of the first settlement shall be completed before the commencement of the pay-in and pay-out of the subsequent settlement(s).
- The cash or securities pay out from the first settlement shall be made available to the member for meeting his pay-in obligations for the subsequent settlement(s).
- Further, in-order to meet their pay-in obligations for the subsequent settlement, members may need to move securities from one depository to another. The depositories shall, therefore, facilitate the inter-depository transfers within one hour and before pay-in for the subsequent settlement begins.

- The CCs and depositories shall follow a strict time schedule to ensure that the settlements are completed on the same day.

## 6.2 Determination of settlement obligations

Clearing Corporation receives the details of trades and prices from the Exchange. Settlement obligations are computed using predefined methodology specified for the segment/product. Some of the methods of determining obligations are listed below:

i. ***Netted obligation***: All purchase and sell transactions will be netted to determine the obligations. Member will have the obligation to deliver a security in a settlement only if the sell quantity is more than buy quantity. Similarly, in case the buy quantity is more than sell quantity, the member will receive a pay-out of the security. Fund obligations will also be computed on a netted basis across all buy and sell transactions under netted settlement.

ii. ***Trade to trade or Gross obligations***: Transactions will not be netted to determine obligations. Member's security pay-in obligation will be equivalent to cumulative sell quantity and security pay-out will be equivalent to cumulative buy quantity. Funds pay-in will be equivalent to cumulative value of buy transactions and funds pay-out will be equivalent to cumulative sell value.

### 6.2.1 Closing Price

Currently, the closing price of stocks in the equity cash segment of the Stock Exchanges is determined on the basis of the Volume Weighted Average Price (VWAP) of trades executed during the last thirty minutes of the Continuous Trading Session (CTS). SEBI, vide circular dated January 16, 2026[106],provide guidelines for the "Introduction of Closing Auction Session (CAS) in the Equity Cash Segment and certain modifications in the Pre-Open Auction Session". The CAS will be made applicable in phased manner. Initially, the closing price of stocks in the cash segment on which derivative contracts are available shall be determined based on CAS (from August 2026). Candidates are requested to refer to the SEBI circular for additional details.

Importance of closing price:

- Basis for the post close session
- Basis for the next day's base price
- Basis for the next day's morning block deal window

[106] https://www.sebi.gov.in/legal/circulars/jan-2026/introduction-of-closing-auction-session-cas-in-the-equity-cash-segment-and-certain-modifications-in-the-pre-open-auction-session_99122.html

- Basis for the computation of end of day index value
- Basis for the settlement of derivatives contracts
- Basis for the computation of Mark to Market margin
- Basis for the computation of NAV for Mutual Funds

## 6.3 Settlement of Funds

Every clearing member shall maintain and operate a separate and distinct primary clearing account with one of the designated clearing banks. Every clearing member shall maintain and operate a separate and distinct primary clearing account for each segment. Clearing members having funds obligation to pay should have clear balance of requisite funds in the clearing accounts on or before the stipulated funds pay-in day and the stipulated time. The clearing banks shall debit/credit the clearing accounts of clearing members as per instructions received from the Clearing Corporation from time to time. Clearing members can deposit funds into these accounts in any form and can withdraw funds from these accounts only in self-name.

### 6.3.1 Mode of Payment

Brokers should not accept cash from the client whether against obligations or as margin for purchase of securities and / or give cash against sale of securities to the clients. All payments shall be received / made by the brokers from / to the clients strictly by account payee crossed cheques / demand drafts or by way of direct credit into the bank account through NEFT, or any other mode allowed by RBI. The brokers shall accept cheques drawn only by the clients and also issue cheques in favour of the clients only, for their transactions. Member shall maintain an audit trail of the funds received through electronic fund transfers to ensure that the funds are received from their clients only. While receiving funds from the clients through pre-funded instruments, such as, Pay Order, Demand Draft, Banker's cheque, etc., members should maintain an audit trail of the funds so received, to ensure that the funds are received only from client bank account.

SEBI has mandated that stockbroker maintain designated client bank account(s), titled "Name of Stock Broker -Client Account", to receive and /or pay funds to their clients. SEBI, vide circular dated December 13, 2023, has advised changing the nomenclature of all such accounts to either of the following two categories: accounts.

- Up Streaming Client Nodal Bank Account (USCNBA):Stock Brokers/Clearing Members shall receive clients' funds in USCNBA.The nomenclature for such accounts shall be "Name of the SB/CM –USCNB account"
- Down Streaming Client Nodal Bank Account (DSCNBA): Payment to clients shall be made only from DSCNBA . The nomenclature for such accounts shall be "Name of the SB/CM –DSCNB account".

Bank account(s) held for the purpose of settlement shall be named "Name of Stock Broker -Settlement Account".

Unless otherwise specifically agreed to by a client, the settlement of funds shall be done within 24 hours/1 working day of the pay-out. However, a client may specifically authorize the stock broker to maintain a running account (only for funds) subject to the following conditions. Vide SEBI circular no. CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019, settlement of running account for securities has been discontinued and therefore, SEBI circulars dated December 03, 2009, September 26, 2016, June 16, 2021 July 27, 2022, and January 06, 2025 are applicable for settlement of running account of client's "funds" only.

a. The authorization shall be dated and revocable.
b. The authorization shall be signed by the client only and not by any Authorized Person on his behalf or any holder of the Power of Attorney.
c. The authorization shall contain a clause that the client may revoke the authorization at any time.
d. The settlement of running account of funds of the client shall be done by the TM after considering the End of the day (EOD) obligation of funds as on the date of settlement across all the Exchanges, at least once within a gap of 30 / 90 days between two settlements of running account as per the preference of the client..
e. The settlement of running account of funds of the client shall be done after considering the End of the day (EOD) obligation of funds across all Exchanges, shall settle the running accounts at the choice of the clients on Quarterly and monthly basis, on the dates stipulated by the Exchanges. Settlement of running account shall be settled on first Friday and/or Saturday of every month/quarter. To ensure uniformity and clarity on date of such monthly and quarterly settlement of client accounts, Stock exchanges shall, jointly, issue the annual calendar for the settlement of running account (quarterly and monthly) at the beginning of the financial year.
f. Further, to safeguard against any possibility of misuse of one client's funds to settle another clients' running account, it is stipulated that any funds received from clients shall remain in the upstreaming account. Trading Member shall ensure that funds, if any, received from clients, whose running account has been settled, remain in the "Up Streaming Client Nodal Bank Account" and no such funds shall be used for settlement of running account of other clients. Stock Exchanges shall evolve a monitoring mechanism for this purpose. The settlement as mentioned shall be effective (i) quarterly settlement of Jan-Mar 2024 and (ii) monthly settlement of January 2024.

g. While settling the account, the broker shall send to the client a 'statement of accounts' containing an extract from the client ledger for funds and an extract from the register of securities displaying all receipts/deliveries of funds/securities.

h. The required bank details for initiating electronic fund transfers shall be obtained from new clients and shall be updated for existing clients. Only in cases where electronic payment instructions have failed or have been rejected by the bank, the stock broker may issue a physical payment instrument.

i. For the clients having an outstanding obligations on the settlement date, the stock broker may retain the requisite funds towards such obligations in the manner specified by SEBI /Stock Exchanges.

j. The client shall bring any dispute arising from the statement of running account to the notice of the broker within 30 working days from the date of statement.

k. Such periodic settlement of running account may not be necessary:
   - for clients availing margin trading facility (MF) as per SEBI circular, to the extent of funds/securities relating to MTF used by client.
   - for funds received from the clients towards collaterals/margin in the form of bank guarantee (BG)/fixed deposit receipts (FDR).
   - In case of institutional clients settling trades through "custodians".

l. The stock broker shall transfer the funds / securities lying in the credit of the client within one working day of the request if the same are lying with him and within three working days from the request if the same are lying with the Clearing Member/Clearing Corporation.

m. For the clients having credit balance, who have not done any transaction in the 30 calendar days since the last transaction and any amount of such client's funds is lying with member for more than such 30 calendar days, the entire credit balance of client shall be returned to the client by TM, on the upcoming settlement dates of monthly running account settlement cycle (irrespective of settlement cycle preferred by the client) as stipulated by stock exchanges . However, if the client trades after 30 calendar days and before aforesaid upcoming settlement dates of monthly running account settlement cycle, the settlement of account of client shall continue to be done by the Trading member as per the preference of quarterly/monthly as indicated by the client for running account settlement.

n. There is no inter-client adjustment for the purpose of settlement of running account.

o. TM shall ensure that funds, if any, received from clients, whose running account has been settled, remain in the "Up Streaming Client Nodal Bank Account" and no such funds shall be used for settlement of running account of other clients. Stock Exchanges shall evolve a monitoring mechanism for this purpose."

p. The Authorized person is not permitted to accept client's funds and securities. The TM should keep a proper check. Proprietary trading by the Authorized person

should be permitted only on his own funds and securities and not using any of the client's fund.

q. Once the TM settles the running account of funds of a client, an intimation shall be sent to the client by SMS on the mobile number and also by email.

Keeping in view the significant advancements in payment systems and with the objective of further enhancing accessibility and safety in the securities market, SEBI[107] has been decided to put in place a structured Unified Payment Interface (UPI') address mechanism for SEBI-registered investor-facing intermediaries ('intermediaries') to collect funds from their investors.

### 6.3.3 Settlement dues

The clearing members and custodians shall pay to the clearing agency whatever is due to them for settlement of their transactions / positions. In turn, the clearing agency shall pay to the clearing members and custodians moneys payable to them for every settlement for their transactions / positions. This is based on the information provided by the Exchange or Clearing Agency.

### 6.3.4 Funds Shortages

Members failing to fulfil their funds obligations (including STT/ Stamp duty obligation and Capital Cushion requirement) by the scheduled date and time (all markets including the valuation debit raised on account of securities shortages) to Clearing Corporation shall render him liable for withdrawal of trading facility or such other actions including disciplinary actions, as may be decided by the Relevant Authority.

In case of pay-in shortfall, the trading facility of the trading member shall be withdrawn, and the securities pay-out would be withheld if:

- the shortfall is in excess of the amount specified by SEBI or the Clearing Corporation from time to time,
- there are recurring fund shortages by the member within a certain period and for a certain amount, as specified by SEBI or the Clearing Corporation from time to time.

The Exchange/Clearing Corporation may levy a penal interest of not less than 0.07 percent per day on the pay-in shortage of the member.

[107] https://www.sebi.gov.in/legal/circulars/jun-2025/adoption-of-standardised-validated-and-exclusive-upi-ids-for-payment-collection-by-sebi-registered-intermediaries-from-investors_94535.html

The funds defaulting member will be allowed such time as may be permitted by the relevant authority, depending upon the facts of the case, to bring in the amount in default. If the funds are not brought in at any time by the funds defaulting member, the Clearing Corporation, at its discretion, will proceed to close out securities in the normal / auction market

## 6.4 Settlement of Securities

Similarly, in the case of securities giving / taking delivery of securities in "demat mode" should be directly to / from the "beneficiary accounts" of the clients except delivery of securities to a recognized entity under the approved scheme of the stock exchange and / or SEBI. With the proposed implementation on direct pay-out of securities to client, the timing of the payout of securities shall be revised from 1:30 PM to 3:30 PM. As a result of Direct Payout, the securities shall be credited to the clients' demat account on the same settlement day by 3:30 pm instead of one working day from the receipt of pay-out from the Clearing Corporation.

In case of sale of securities, immediately on receipt of intimation of execution of trade from broker, the seller client should issue delivery instructions slip to the DP with whom client maintains his demat account. Securities are transferred to the broker's clearing pool account, as advised by his broker. Clients can give 'Demat Debit and Pledge Instruction'(DDPI) under which the clients shall explicitly agree to authorize the stock broker/stock broker and depository participant to access their BO account for the limited purpose for transferring securities from their individual demat account to broker's pool account for the purpose of meeting their pay-in obligation.

A purchaser of securities can give one-time standing instruction to his DP for receiving securities in his account. This standing instruction can be given at the time of opening of account or later. Alternatively, the client may choose to issue separate receipt instruction to his DP every time the client makes any purchase of securities.

Participant are requested to refer to section 5.6.2 & 5.6.3 related to Block Mechanism in demat account of clients undertaking sale transactions & Validation of Instructions for Pay-In of Securities from Client demat account to Member Pool Account against obligations received from the Clearing Corporations with regards to settlement of securities.

### 6.4.1 Settlement through the Depository Clearing System

In the Cash segment the securities pay-in takes place on the T+0 and / or T+1 day based on settlement cycle. Members shall maintain settlement accounts at both depositories viz. NSDL and CDSL and provide specific pay-in instructions to depositories for effecting pay-in.

Members may note that the maintenance of active pool accounts in both depositories is mandatory even if they have opted for the facility of receiving their pay-out in their preferred depository. Trading members who are clearing their trades with other clearing members shall be required to maintain Trading member pool accounts with both the depositories.
The settlement number and market type are crucial identifiers in equity securities settlement, primarily for ensuring accurate matching, processing, and finalization of trades within the correct regulatory framework.

The settlement number is a unique identifier that tags a specific transaction or a batch of transactions belonging to a particular settlement cycle. It links a trade to a specific settlement date, ensuring that all obligations (pay-in/pay-out of funds and securities) are met on the correct day. It is used by brokers, clearing corporations, and depositories to reconcile their records and confirm the cumulative obligations of each member for that specific cycle.

"Settlement Type / Market type" refers to the specific segment or category under which a trade is executed (e.g., normal, auction, limited physical market, etc.). The settlement/market type determines the specific rules and timeline that apply to the settlement process. The market type dictates whether trades are settled in dematerialized (electronic) or physical form (the latter is now rare but exists for specific limited physical markets), whether it is gross settlement or trade for trade settlement etc.

Periodically Clearing Corporations provides details of settlement number and settlement/market type.

Stock brokers are required to maintain demat accounts only under the following 6 categories specified by SEBI.

| Sr. No. | Demat Account Category | Purpose of Demat Account |
|---|---|---|
| 1 | Proprietary Account | Hold own securities |
| 2 | Pool account | Settlement Purpose |
| 3 | Client Unpaid Securities Pledgee Account | For pledging of Unpaid Securities of Clients |
| 4 | Client Securities Margin Pledge Account | For Margin obligations to be given by way of Pledge/ Re-pledge |
| 5 | Client Securities under Margin Funding Account | Hold funded securities in respect of margin funding |
| 6 | Client Nodal MFOS Account | For subscription/ redemption of MFOS units |

With regard to the handling of unpaid securities (i.e., the securities that have not been paid for in full by the clients), by member please refer section 4.2.5.

**Physical Settlement of F&O Securities**

As per the SEBI circular SEBI/HO/MRD2_DCAP/P/CIR/2022/165 dated November 30, 2022, obligations in the physical settlement of the F&O segment for a particular expiry shall be netted with Obligations in the Capital Market segment of the corresponding trade date. The obligation shall be netted where the clearing member-trading member-client (UCC Code) is common across the Capital Market and F&O segments for the same security. The net sell or buy obligations shall be settled in the Capital Market segment in the settlement/market type and settlement number of the Capital Market segment only.

## 6.5 Auction of Securities

Members failing to fulfil their securities deliverable obligations to the Clearing Corporation shall be subjected to a penalty. Further, the valuation amount of the shortage will be considered as a funds shortages where shortage confirmation is not received from the clearing bank.

When there are shortages in delivery by a seller broker, CC will conduct the buy-in auction. The clearing corporation conducts a buy-in auction through Exchange system to buy shares from open market for delivering to buyer broker. Auctions are conducted on settlement day. Securities shortages occurs generally when a short seller fails to square up the position, or a seller fails to deliver shares on time, or a seller delivers bad/wrong shares. Once shortages are identified, the members are debited by an amount equivalent to the securities not delivered and valued at a valuation price. This is known as **valuation debit**.

**The whole process of this auction event can be illustrated as under:**

An auction is a mechanism utilized by the clearing corporation to fulfill its obligation towards the buying trading members. Thus, when the selling broker fails to deliver the shares, the clearing corporation through stock exchanges system conducts an open market purchase by way of an open auction and the shares so bought through the auction are delivered to the buying broker.

### 6.5.1 Auction of securities on Exchanges/Clearing Corporation

An auction tender notice is issued by Exchanges/CCs to the trading members informing them about the a) names of the scrips which are short or have not been delivered, b) quantity slated for auction and c) the date and time of the auction session on the Exchanges.

The auction for the undelivered quantities is conducted on settlement day after completion of payout between 2:00 p.m. and 2.45 p.m. (in case BSE) and 2:30 pm onwards (in case of NSE) for all the scrips under compulsory rolling settlements other than scrips which are directly close-out (e.g., trade for trade securities etc.) and securities are under corporate action. In no case the auction would be held more than once unless the same is approved by a special resolution of the governing board of the CC. In no case the auction shall be held beyond a period of one week from the pay-in day of the settlement in which the concerned contract was entered into.

The members participating in the auction session, will receive the obligation for securities pay-in on the same day, if their offers are accepted. The members are required to deliver the shares to the clearing corporation on or before the auction pay-in day, i.e., Auction + 1 day (within the time specified by clearing corporation). The auction funds paying members are required to have clear balance of funds in their clearing account towards obligation within the time specified by clearing corporation on settlement day. Pay-out of auction shares and funds is also done on the Auction + 1 day.

**6.5.1.1 Self Auction / Auction for Internal Shortages**

In some cases, a selling client has failed to deliver the shares sold in a settlement to a member. However, this may not result in failure of the Member to deliver the shares to the Clearing House as there was a purchase transaction by his other buying client in the same security and the same was netted off for the purpose of settlement. In such a case, the Member would require shares so that he can deliver the same to his buying client, which otherwise would have taken place from the delivery of shares by his selling client. These shortages are called internal shortages.

To understand this better, assume that a client has sold the shares of a Company 'X' but fails to deliver those shares to its trading member and other client of same member has bought the similar quantity of shares of company 'X'. Due to netting, there is no security obligation for member from clearing corporation. As selling client is not able to deliver the shares, member is not able to make delivery to buying client. To provide shares to the trading members in such cases, member have been given an option by clearing corporation to submit the details of such internal shortages on pay-in day for conducting self-auction. These shortages are clubbed with the normal shortages in a settlement arrived at by the clearing house/clearing corporation and the auction is conducted by the clearing corporation/clearing house for the combined shortages.

To handle shortages arising due to inter se netting of positions between clients with introduction of Direct Pay-out of securities in client account, SEBI has advised TM/CM to handle such shortages through the process of auction as specified by CCs. Further, SEBI advised TM/CM in above cases not to levy any charges on the client over and above the charges levied by the CCs. Where clearing corporation is not able to obtain securities, member shall close-out such shortages as per guidelines provided by Clearing Corporations.

CCs may charge fees for facilitating such internal auction. Further, CC may not provide any settlement guarantee for auction of internal shortages.

**6.5.2 Close Out Procedure**

Whenever there is short delivery of securities, Clearing Corporation/ Clearing House will conduct auction to buy the shares from the market participants. If on the auction day, there are no sellers for a particular short delivery, the Clearing Corporation / Clearing House will then carry out a process called "Close out". In this process, the seller will be charged with the highest price prevailing across the stock exchange from the day of trading till the auction day or 20% above the official closing price (settlement price) on the auction day, whichever is higher.

In case a company announces any corporate action, short deliveries, if any, of the shares traded on cum basis shall be directly closed out. The Clearing Corporation shall announce an ex-date and all cum-transactions shall go for auction if the auction pay-out happens on or before the Record date / Book closure minus 1 business day. Where auction pay-out cannot be done on or before Record Date/ Book closure minus 1 business day, shortages shall be directly closed out at the highest price prevailing across the Exchanges from the day of trading till the day of auction or 10% above the settlement price on the auction day, whichever is higher, or as declared from time to time.

In certain delivery shortages, clearing corporation directly does the close-out without conducting an auction. For e.g., Securities under trade for trade category, securities under corporate action, trades done on block deal window etc. For shortages in the Block window and TFT segment, the position will be directly closed-out on settlement at the highest price prevailing across the Exchanges on the T day (till settlement minus one day) or 20% above the settlement price on the T day (or settlement minus one(1) day), whichever is higher.

Auction shall not be conducted in case of securities shortage for optional T+0 settlement. Security shortages shall be directly closed out at 10% above the highest price of the day across all exchanges for the T+0 market.

When the auction seller fails to deliver the securities (partly or fully) on the auction pay-in day, the deal will be closed out at the highest price prevailing across the Exchange from the day on which the trade was originally executed till the day of auction or 20% over the official closing price on the close out day whichever is higher and will be charged to the auction seller unless otherwise specified.

The Proceeds from Auction or Close-out should be used to settle the claim of the aggrieved party. Any amount remaining thereof should be credited to the Core Settlement Guarantee Fund ("Core SGF") instead of crediting it to the defaulting party's account.

## 6.6 Settlement of Equity Derivatives

Since October 2019, all positions in futures and options on individual securities that remain open on the expiry date of the contract are required to be settled by physical delivery. Index futures and options continue to be settled in cash. Hence, this section discusses the regulations related to clearing and settlement for both categories of contracts (i.e., cash-settled and physically settled).

**Settlement of futures contracts:**

Futures contracts have two types of settlements: (A) the mark-to-market (MTM) settlement, which happens on a continuous basis at the end of each day, and (B) the final settlement, which happens on the last trading day of the futures contract.

(A) Mark-to-market (MTM) settlement: Mark to Market (MTM) is a process by which margins are adjusted based on daily price changes in the markets for underlying assets. The clearing member who suffers a loss is required to pay the MTM loss amount, which is passed on to the clearing member who has made an MTM profit. Clearing members are responsible for collecting and settling the daily MTM profits/losses incurred by the TMs and their clients clearing and settling through them. After completing the day's settlement process, all the open positions are reset to the daily settlement price. These positions become the open positions for the next day. The daily MTM of all futures contracts are cash-settled.

| **XYZ Index Futures (XX Expiry)** | | | | 1 contract = 200 lots |
|---|---|---|---|---|
| Date (A) | Buy Price (B) | Settlement Price (C) | Mark to Market Spread (D) | Per contract P&L (E) |
| | | | C-B | D*200 |
| 21-XX-202X | 2502.00 | 2508.00 | 6.00 | 1200 |
| 22-XX-202X | 2508.00 | 2532.00 | 24.00 | 4800 |
| 23-XX-202X | 2532.00 | 2548.00 | 16.00 | 3200 |
| 24-XX-202X | 2548.00 | 2510.00 | -38.00 | -7600 |
| 27-XX-202X | 2510.00 | 2532.00 | 22.00 | 4400 |

| | | | | |
|---|---|---|---|---|
| 28-XX-202X | 2532.00 | 2520.00 | -12.00 | -2400 |
| 29-XX-202X* | 2520.00 | 2545.00* | 25.00 | 5000 |
| | | **Net Effect** | **43.00** | **8600.00** |

* Final Settlement price on expiry

(B) Final settlement of futures contracts: On the expiration day of the futures contracts, after the close of trading hours, the clearing corporation marks all positions of a clearing member to the final settlement price

Final settlement procedure for cash-settled futures contracts: All positions (brought forward, created during the day, or closed out during the day) of a clearing member in futures contracts, at the close of trading hours on the last trading day of the contract which are cash settled, are marked to market at the final settlement price (for final settlement) and settled. The members having a funds pay-in obligation must have a clear balance of funds in their clearing account towards their pay-in obligation by the declared pay-in time on the settlement day. The pay-out of funds is credited to the receiving member's clearing account thereafter.

Final settlement procedure for futures contracts settled by physical delivery:

Settlement procedure: All open futures positions after the close of trading on the expiry day will be considered for physical settlement. In the case of physically settled futures contracts, the final exercise settlement is implemented on the T+1 date in accordance with the settlement schedule of the clearing corporation, where T is the expiry date. Settlement obligations shall be computed at the futures' final settlement price of the respective contract. (The difference between previous day's settlement price/trade price and the final settlement price on the expiry date shall be cash settled along with the daily MTM on T+1 basis).

**Settlement of options contracts:**

Options contracts have two types of settlements: Daily premium settlement and Final settlement.

(A) Daily Premium Settlement

The buyer of an option pays the premium, while the seller receives the same. The amount payable and receivable as premium are netted to compute the net premium payable or receivable amount for each client for each option contract.

(B) Final Exercise Settlement

All the in-the-money (ITM) stock options contracts are automatically exercised on the expiry day. ITM contracts are those that have some intrinsic value on the expiry day.

Final exercise settlement of cash settled index options: Index options in India are European-style options, meaning that they can be exercised only on the expiry day. All long positions

in ITM options are automatically assigned randomly to short positions in option contracts with the same series. The final settlement price is the closing price of the underlying (index or security) on the expiry day of the relevant option contract. The final exercise settlement value is the difference between the final settlement price and the strike price of the option. The exercise settlement value for each unit of the exercised contract is computed as follows:
Call options = Closing price of the security on the day of exercise - Strike price
Put options = Strike price - Closing price of the security on the day of exercise.

Final exercise settlement of physically settled stock options: The settlement obligation in respect of exercised ITM options is computed as under:
(i) In the case of ITM call options, exercise of a long call results into a buy (security receivable) position and assignment of a short call results into a sell (security deliverable) position.
(ii) In the case of ITM put options, exercise of a long put results into a sell (security deliverable) position and assignment of a short put results into a buy (security receivable) position.
Settlement Obligation Value: The settlement obligation for options contract is computed at respective strike prices of the option contracts.

Please note that, the daily & final settlement of derivative trades is done on T+1 working day basis except for final settlement of currency derivatives segment, where final settlement take place on a T+2 basis.

**6.6.1 Settlement price for derivatives contract:**

Daily settlement price: Closing price of the contract (specific Exchange or across Exchanges) is considered as daily settlement price. In case of illiquid contracts theoretical price is computed based on the SEBI guidelines.

Final Settlement Price for derivatives is given in the following table:

| **Product** | **Settlement** | **Price** |
|---|---|---|
| Futures and Options Contracts on Index or Individual Securities | Final Settlement | a. Index- Closing price of the relevant underlying index on the last trading day of the futures or options contract on the given exchange.<br>b. Individual Securities- Closing price of the relevant underlying security in the Capital Market Segment across exchanges on |

| Product | Settlement | Price |
|---|---|---|
| | | the last trading day of the futures or options contract. |
| Currency Futures and Options | Final Settlement | FBIL reference rate / Rate derived from FBIL reference rate. |
| Cash Settlement GOI Bond Futures & Options | Final Settlement | Weighted average price of the underlying bond based on the process during the last two hours of the trading on NDS-OM[108] subject to minimum of 5 trades otherwise, the FIMMDA / FBIL price is applicable. |

### 6.6.2 Funds Settlement:

The funds obligation of daily mark to market settlement, final settlement of futures contracts that are cash settled, premium settlement and the final exercise settlements of options contracts that are cash settled are generated on net basis at clearing member level. Funds pay-in is effected before the start of market hours on the next day, as per the settlement schedule specified by the Clearing Corporation. The pay-out of funds shall be credited to the receiving member's clearing account thereafter. The mechanism will be similar to that of the cash market.

### 6.6.3 Securities Settlement:

The final deliverable/receivable positions at a clearing member shall be arrived at after netting the obligations of all clients/constituent/trading members clearing through the respective clearing member. SEBI has introduced the mechanism of Net Settlement of the cash segment and the F&O segment upon expiry of stock derivatives. The obligations arising out of cash segment settlement and physical settlement of the F&O segment, upon the expiry of stock derivatives, shall be settled on a net basis as against the earlier approach of settling such obligations separately. This has been explained in the previous chapter [Box 5.1]. The net sell or buy obligations shall be settled in the Capital Market segment in the settlement/market type and settlement number of the Capital Market segment only.

## 6.7 Corporate Actions Adjustment

### 6.7.1 Corporate actions record date and ex-date

[108] NDS-OM is a screen based electronic anonymous order matching system for secondary market trading in Government securities owned by RBI.

Companies announce benefits or changes for their shareholders as of a given date in the form of corporate actions. These benefits or changes can be in the form of entitlements such as rights shares, bonus shares, stock splits, dividends, etc. Investors are considered eligible shareholder in the records of the company if they hold the shares on the given date, which is also known as the record date[109].

Corporate Action adjustment in case of Bonus issue

| **Company Name** | **XYZ Ltd.** | |
|---|---|---|
| Record Date | May 28, 2025 | Benefit will be available for those investors who will be holding securities in their demat account on May 28, 2025, EOD |
| Corporate Action Date | Bonus share in the ration of 1:1 | |
| Ex-Date | May 28, 2025 | From May 28, 2025, securities will be traded on Ex-benefit basis |
| Close price as on May 27, 2025 | Rs. 500 | - |
| Adjusted base price for May 28, 2025 | Rs. 250 | - |

Due to the T+1 Rolling Settlement, an Investor who bought securities on May 27, 2025, will receive securities in their demat account on May 28, 2025, before EOD. Such investors will be eligible for bonus shares. An investor who bought securities on May 28, 2025, will receive the securities in their demat account on May 29, 2025, before EOD and, hence not be eligible for the corporate action benefit.

Corporate actions like Bonus, Rights, Extra-ordinary dividends, Merger/Demerger, Amalgamation, Splits and Consolidations etc. will result in adjustments in the futures & options contracts of the underlying stock which is undergoing the corporate action. The following section enumerates some of this.

The basis for any adjustment for corporate actions in the equity F&O segment shall be such that the value of the position of the market participants, on the cum and ex-dates for the corporate action, shall continue to remain the same as far as possible. This will facilitate in

[109] A stock is said to trade with the benefits of the corporate action or cum-benefit (i.e. cum-rights, cum-dividend, etc.) up to 1 trading days before the record date after which it trades without the benefit or ex-benefit. The date a stock starts trading ex-benefit is known as the ex-date. In equity segment, Exchanges adjust base price of the stock from the date the stock start trading without benefit. Exchange provide information about corporation action along with Record date and Ex-date.

retaining the relative status of positions viz. in-the-money, at-the-money and out-of-money. This will also address issues related to exercise and assignments.

**6.7.2 Corporate Actions to be adjusted**

The corporate actions may be broadly classified under stock benefits and cash benefits. The various stock benefits declared by the issuer of capital are:

- Bonus
- Rights
- Merger / De-merger
- Amalgamation
- Splits
- Consolidations
- Hive-off
- Warrants, and
- Secured Premium Notes (SPNs) among others.

The cash benefit declared by the issuer of capital is cash dividend

**6.7.2 Time of Adjustment**

Any adjustment for corporate actions would be carried out on the last day on which a security is traded on a cum basis in the underlying equities market after the close of trading hours.

**6.7.3 Adjustment in Equity F&O segment**

Adjustments may entail modifications to positions and/or contract specifications as listed below, such that the basic premise of adjustment laid down above is satisfied:

a) Strike Price
b) Position
c) Market Lot /Multiplier

In a lot of cases, adjustments may result in the change in date of expiry of the contract as well i.e., contract will be force closed before the expiry date and the adjusted contracts will trade instead. The adjustments would be carried out on any or all of the above, based on the nature of the corporate action. The adjustments for corporate actions would be carried out on all open positions.

**6.7.4 Methodology for adjustment in Equity F&O**

The methodology to be followed for adjustment of various corporate actions to be carried out are as follows:

#### 6.7.4.1 Bonus, Stock Splits and Consolidations

**Strike Price:**

The new strike price shall be arrived at by dividing the old strike price by the adjustment factor as under.

**Market Lot / Multiplier:**

The new market lot/multiplier shall be arrived at by multiplying the old market lot by the adjustment factor as under.

**Position:**

The new position shall be arrived at by multiplying the old position by the adjustment factor as under.

**Adjustment factor:**

| | |
|---|---|
| Bonus - Ratio A:B | Adjustment factor : (A+B)/B |
| Stock Splits and Consolidations Ratio - A : B | Adjustment factor : A/B |

#### 6.7.4.2 Rights

**Strike Price:**

The new strike price shall be arrived at by multiplying the old strike price by the adjustment factor as under.

**Market Lot / Multiplier:**

The new market lot/multiplier shall be arrived at by dividing the old market lot by the adjustment factor as under.

**Position:**

The new position shall be arrived at by dividing the old position by the adjustment factor as under.

| |
|---|
| Rights<br><br>Rights Entitlement = A<br>Number of Existing shares = B<br>Total Entitlement = A+B<br>Underlying close price on the last cum date = P<br>Issue price of the rights = S<br>Benefit per Right Entitlement = (P – S) *A<br>Benefits per share = E |

E = (P-S)*A/(A+B)
Adjustment Factor is = (P-E)/P
Dividend if any, declared by the company along with rights shall be adjusted as per the prevailing dividend adjustment policy in Equity F&O Segment.

**Adjustment in case of Fraction**

The above methodology may result in fractions due to the corporate action, e.g., a bonus ratio of 3:7. With a view to minimizing fraction settlements, the following methodology is adopted:

1. Compute value of the position before adjustment.
2. Compute value of the position taking into account the exact adjustment factor.
3. Carry out rounding off for the Strike Price to the nearest tick size and Market Lot to nearest integer.
4. Compute value of the position based on the revised strike price and market lot.

The difference between 1 and 4 above, if any, is decided in the manner laid down by the relevant authority by adjusting Strike Price or Market lot, so that no forced closure of open position is mandated.

**6.7.4.3 Dividends**

For the purpose of adjustments in equity F&O, dividends which are below 2 percent of the market value of the underlying stock, would be deemed to be ordinary dividends and no adjustment in Equity F&O would be made for ordinary dividends.
For extra-ordinary dividends i.e., at and above 2 percent[110] of the market value of the underlying security or all cases of dividends , where the listed entity has sought exemption from the timeline prescribed under the provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 there would be adjustment in Equity F&O.

To decide whether the dividend is "extra-ordinary" (i.e. 2 percent of the market price of the underlying stock.), the market price would mean the closing price of the scrip on the day previous to the date on which the announcement of the dividend is made by the Company after the meeting of the Board of Directors. However, in cases where the announcement of dividend is made after the close of market hours, the same day's closing price would be taken as the market price. Further, if the shareholders of the company in the AGM change the rate of dividend declared by the Board of Directors, then to decide whether the dividend is extra-ordinary or not would be based on the rate of dividend communicated to the

[110] SEBI/HO/MRD2/MRD2_DCAP/P/CIR/2022/90.

Exchange after AGM and the closing price of the scrip on the day previous to the date of the AGM.
In case of declaration of "extra-ordinary" dividend by any company, the total dividend amount (special and/or ordinary) would be reduced from all the strike prices of the option contracts on that stock. The revised strike prices would be applicable from the ex-dividend date specified by the Exchange. All open positions shall be carried forward at the daily settlement price less dividend amount for the respective futures contract.

**6.7.4.4 Mergers / Demergers**

On the announcement of the record date for the merger, the exact date of expiration (last cum-date) would be informed to members.

After the announcement of the Record Date, no fresh contracts on futures and options in equity derivatives (futures and options) would be introduced on the underlying, that will cease to exist subsequent to the merger/demerger.

Un-expired contracts outstanding as on the last cum-date would be compulsorily settled at the settlement price. The settlement price shall be the closing price of the underlying on the last cum-date.

Demerger:
All the following conditions shall be met in the case of shares of a company undergoing restructuring through any means for eligibility to re-introduce derivative contracts on that company from the first day of listing of the post restructured company's stock (herein referred to as post restructured company) in the underlying market.
a. the futures and options contracts on the stock of the original (pre restructure) company were traded on any Exchange prior to its restructuring;
b. the pre restructured company had a market capitalization of at least Rs.1000 crores prior to its restructuring;
c. the post restructured company would be treated like a new stock and if it is, in the opinion of the Exchange, likely to be at least one-third the size of the pre restructuring company in terms of revenues, or assets, or (where appropriate) analyst valuations; and
d. in the opinion of the Exchange, the scheme of restructuring does not suggest that the post restructured company would have any characteristic (for example extremely low free float) that would render the company ineligible for derivatives trading,

If the above conditions are satisfied, then the following course of action in dealing with the existing derivative contracts on the pre-restructured company and introduction of fresh contracts on the post restructured company:

a) All existing contracts of the security shall be expired on the last cum date.
b) The Exchange shall introduce near month, middle month and far month derivative contracts on the stock of the restructured company from the ex-date of the demerger.

**6.7.4.5 Other Corporate Actions**

The relevant authority may, on a case by case basis, carry out adjustments for other corporate actions in conformity with the above guidelines, including compulsory closing out, where it deems necessary.

**Chapter 6: Sample Questions**

1. In case of sale of securities, what instruction should be given to the DP, upon receipt of intimation of execution of trade from broker with whom he maintains the demat account.

   (a) Credit

   **(b) Debit**

   (c) Hold

   (d) No action to be taken.

2. Corporate action adjustments are done on all _____ positions.

   **(a) Open**

   (b) Closed

   (c) Past

   (d) Executed

3. What is the action taken when there is a failure on part of the broker to deliver the securities?

   (a) Sale

   **(b) Auction**

   (c) Trade Cancelled

4. In case of declaration of "extra-ordinary" dividend by any company, the total dividend amount would be _____from all the strike prices of the option contracts on that stock.

   **(a) Reduced**

   (b) Increased

   (c) Unchanged

5. For the computation of closing index value, _____ of equity shares is considered.

**(a) Closing Price**

(b) Last Traded Price

(c) Base Price

6. Brokers should not accept _____ from the client whether against obligations or as margin for purchase of securities.

**(a) Cash**

(b) Demand Draft

(c) Crossed Cheque

7. If record date for company is December 22, 202X, then what will be ex-date in equity segment in case of T+1 settlement.

(a) December 21 202X

**(b) December 22 202X**

(c) December 23 202X

8. In Currency Derivatives segment the final settlement happen on expiry + _____ days.

(a) 0

(b) 1

(d) **2**

# CHAPTER 7: INVESTOR GRIEVANCES AND ARBITRATION

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Investor Grievance
- Online Resolution of Disputes
- Investor Protection Fund
- Arbitration process

## 7.1 Introduction

Investors are the backbone of the securities market. Protection of the interests of investors is of paramount importance for the intermediaries; stock exchanges and the regulators associated with the markets. Regulations and compliance efforts have been put in place to protect the investors against any intentional or unintentional wrong doing or activities of any of the participants in the market.

However, there may be occasions when the investors have grievances against a) intermediary/broking firm through which it is carrying out the transactions or/and (b) against the company of which it is a shareholder.

## 7.2 Investor Grievance

In the following sections of this chapter, we would explain the procedures followed in the Indian securities market for redress of investor grievances. Investor grievance is handled at the trading member level, stock exchange level and the regulator level, each of which have been explained below:

### 7.2.1 Investor Grievance handling at the trading member level

All the trading firms have a designated cell/person for redressing investor grievances. When a complaint is filed by the investor, matter has to be resolved at the branch level or the firm level depending upon the nature of the complaint. All the registered brokers shall designate an e-mail ID of the grievance redressal division/compliance officer exclusively for the purpose of registering complaints by investors. The broker shall also display the email ID and other relevant details prominently on their websites and in the various materials/pamphlets/advertisement campaigns initiated by them for creating investor

awareness. Further, for information of all investors who deal/ invest/ transact in the market, the offices of all stock brokers (its registered authorized person(s)) shall prominently display basic information, as provided in Exhibit 7.1 below, about the grievance redressal mechanism available to investors.

**Exhibit 7.1**

Dear Investor,

In case of any grievance / complaint against the stock broker / Depository Participant:

Please contact compliance officer of the Stock Broker / Depository Participant (Name) / email-id (xxx.@email.com) and Phone No. 91-XXXXXXXXXX

You may also approach CEO / Partner/ Proprietor (Name) / e-mail id (xxx.@email.com ) and Phone No. – 91 – XXXXXXXXXX

If not satisfied with the response of the Stock Broker / Depository Participant, you may contact the concerned Stock Exchange / Depository at the following:

| | Web Address | Contact No. | Email-id |
|---|---|---|---|
| BSE | www.bseindia.com | XXXXXXXXXX | xxx@bseindia.com |
| NSE | www.nseindia.com | XXXXXXXXXX | xxx@nse.co.in |
| MSEI | www.msei.in | XXXXXXXXXX | xxx@msei.in |

| | Web Address | Contact No. | Email-id |
|---|---|---|---|
| CDSL | www.cdslindia.com | XXXXXXXXXX | xxx@cdslindia.com |
| NSDL | www.nsdl.co.in | XXXXXXXXXX | xxx@nsdl.co.in |

You can also lodge your grievance with SEBI at http://scores.sebi.gov.in. For any queries, feedback or assistance, please contact SEBI Office on Toll Free Helpline at 1800 22 7575 / 1800 266 7575.

The stock broker shall endeavor to redress investor grievances promptly within the time specified (currently within 21 calendar days from the receipt of compliant) by the SEBI/Exchanges from time to time. The stock broker shall maintain records regarding investor grievances received by it and redressal of such grievances.

SEBI has issued circular for "Publishing Investor Charter and disclosure of Investor Complaints by Stock Brokers on their websites".[111] SEBI has prepared an Investor Charter for Stock Brokers inter-alia detailing the services provided to Investors, Rights of Investors, various

[111] Vide Circular: SEBI/HO/MIRSD/MIRSD-PoD1/P/CIR/2025/22 Dated February 21, 2025 "Investor Charter For Stock Brokers".

activities of Stock Brokers with timelines, DOs and DON'Ts for Investors and Grievance Redressal Mechanism. SEBI has advised member to provide investor grievance redressal within 21 calendar days from the receipt of complaints from investor. Stock Exchanges are directed to advise Stock Brokers to bring the Investor Charter to the notice of their clients (existing as well as new clients) through disclosing the Investor Charter on their respective websites, making them available at prominent places in the office, provide a copy of Investor Charter as a part of account opening kit to the clients, through e-mails/ letters etc. Further, in order to bring about transparency in the Investor Grievance Redressal Mechanism, all the Stock Brokers shall disclose on their respective websites, the data on complaints received against them or against issues dealt by them and redressal thereof, latest by seventh of succeeding month, as per SEBI provided format (Refer Annexure B of SEBI circular dated February 21, 2025). Further, according to SEBI (Intermediaries) Regulations 2008, the stock broker shall at the end of each quarter of a financial year ending on 31st March upload information about the number of investor grievances received, redressed and those remaining unresolved beyond three months of the receipt thereof by the stock broker on the website.

List of various activities with timeline provided in Investor Charter for Stock Broker.

| **No.** | **Activities** | **Expected Timelines** |
|---|---|---|
| 1. | KYC entered into KRA System and CKYCR | 3 working days of account opening |
| 2. | Client Onboarding | Immediate, but not later than one week |
| 3. | Order execution | Immediate on receipt of order, but not later than the same day |
| 4. | Allocation of Unique Client Code | Before trading |
| 5. | Copy of duly completed Client Registration Documents to clients | 7 days from the date of upload of Unique Client Code to the Exchange by the trading member |
| 6. | Issuance of contract notes | 24 hours of execution of trades |
| 7. | Collection of upfront margin from client | Before initiation of trade |
| 8. | Issuance of intimations regarding other margin due payments | At the end of the T day |

| No. | Activities | Expected Timelines |
|---|---|---|
| 9. | Settlement of client funds | First Friday/Saturday of the month / quarter as per Exchange pre-announced schedule |
| 10. | 'Statement of Accounts' for Funds, Securities and Commodities | Monthly basis |
| 11. | Issuance of retention statement of funds/commodities | 5 days from the date of settlement |
| 12. | Issuance of Annual Global Statement | 30 days from the end of the financial year |
| 13. | Investor grievances redressal | 21calendar days from the receipt of the complaint |

### 7.2.2 Investor Grievance handling at the Stock Exchanges and SEBI

In case the complainant or the aggrieved investor is unsatisfied with the redressal process of the trading member then the investor can take his grievance to the stock exchange or SEBI.

#### 7.2.2.1 SEBI Complaints Redressal System (SCORES)

SEBI handles the investor grievances through a system called SEBI Complaints Redress System (SCORES). SCORES is a web based centralized system to capture investor complaints against listed companies and registered intermediaries and is available 24x7. Salient features of SCORES are:

- Centralized database of all complaints.
- User friendly interface
- Effective redressal mechanism
- Feed based system
- Online movement of complaints to the concerned entities.
- Online upload of Action Taken Reports (ATRs) by the concerned entities.
- Realtime tracking of status of complaints by investors.

It allows the investors to lodge their complaints and track the status online. Investors who wish to lodge a complaint on SCORES are requested to register themselves on www.scores.sebi.gov.in[112] When a complaint is lodged on SCORES, an email

[112]https://www.sebi.gov.in/legal/circulars/mar-2018/investor-grievance-redress-mechanism-new-policy-measures_38481.html

acknowledgement is generated for reference and tracking. The system also allows market intermediaries and listed companies to receive complaints lodged against them electronically. SEBI encourages the investors to lodge complaints through electronic mode in SCORES. However, if an investor submits a manual complaint, the same is digitized by SEBI and uploaded on SCORES. Thereafter, follow-up actions of the complaint are done in electronic form only i.e., through SCORES. Investors can easily access, retrieve and preserve the complaints lodged by them in electronic mode. Further, it enhances the turnaround time and speed of redressal of a complaint.

Investors may contact the Investor Associations (IAs) recognized by SEBI for any assistance in filing complaints on SCORES. The lists of Investor Associations are available on SEBI website (www.sebi.gov.in). Investors may also seek assistance in filing complaints on SCORES from SEBIs toll free helpline numbers. SEBI has received inputs from listed companies and intermediaries that investor grievances can be resolved faster if the grievance been taken up directly with the entity at the first instance. Accordingly, it is now mandatory for investors to first take up their grievances for redressal with the entity concerned, through their designated persons/officials who handle issues relating to compliance and redressal of investor grievances. In case, the entity concerned fails to redress the complaint within the timeline provided herein, the investor may then file their complaint in SCORES.

SEBI vide circular SEBI/HO/OIAE/IGRD/CIR/P/2023/156 dated September 20, 2023, provided revised framework for Redressal of investor grievances through the SEBI Complaint Redressal (SCORES) Platform and linking it to Online Dispute Resolution platform. Few details of the revised framework is given below. For details candidates are requested to refer the SEBI circular.

**Submission of the Complaint and handling of the Complaint by the Entity:**

- All Entities who are in receipt of the complaints of the investors through SCORES, shall resolve the complaint within 21 calendar days of receipt of such complaint.
- The Complaints lodged on SCORES against any Entity shall be automatically forwarded to the concerned Entity through SCORES for resolution and submission of Action Taken Report (ATR). Entities shall resolve the Complaint and upload the ATR on SCORES within 21 calendar days of receipt of the Complaint. The ATR of the entity will be automatically routed to the complainant.
- The Designated Body (for Stock broker, Stock Exchange is Designated Body) shall ensure that the concerned Entity submits the ATRs within the stipulated time of 21 calendar days.

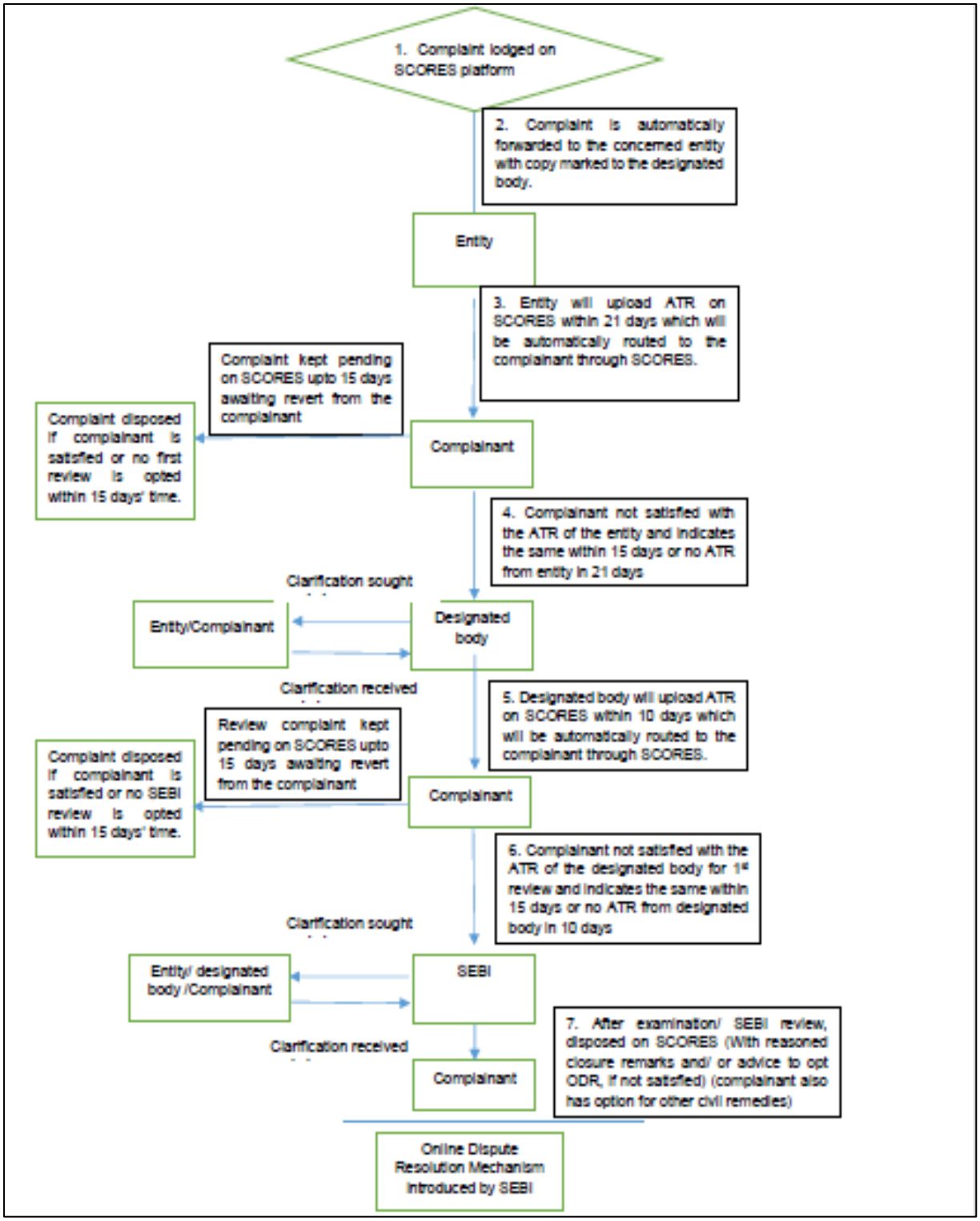
- If the complainant is not satisfied, the complainant may request for a review of the resolution provided by the entity within 15 calendar days from the date of the ATR.

- The Designated Body may seek clarification on the ATR submitted by the Entity for the first review. The concerned Entity shall provide clarification to the respective Designated Body, wherever sought and within such timeline, as the Designated Body may stipulate. The Designated Body shall stipulate the timeline in such as manner to ensure that the Designated Body submits the revised ATR to the complainant on SCORES within 10 calendar days of the review sought

- The complainant may seek a second review of the Complaint within 15 calendar days from the date of the submission of the ATR by the Designated Body. In case the complainant is satisfied with the ATR provided by the concerned Designated Body or complainant does not choose to review the Complaint within the period of 15 calendar days, the Complaint shall be disposed on SCORES. In case the complainant is not satisfied with the ATR provided by the Designated Body or the concerned Designated Body has not submitted the ATR within 10 calendar days, SEBI may take cognizance of the Complaint for second review through SCORES.

- The second review Complaint shall be treated as 'resolved' or 'disposed' or 'closed' only when SEBI 'disposes' or 'closes' the Complaint in SCORES. Hence, mere filing of ATR with respect to SEBI review complaint will not mean that the SEBI review complaint is disposed.

A pictographic representation of the SCORES process is given below:




Presently, the limitation period for filing an arbitration reference with stock exchanges is three years. In line with the same and in order to enhance ease, speed & accuracy in redressal of investor grievance, the investor may lodge a complaint on SCORES within one years from the date of cause of action

- where Investor has approached the listed company or registered intermediary for redressal of the complaint **and**,
- The concerned listed company or registered intermediary rejected the complaint **or**,
- The complainant does not receive any communication from the listed company or intermediary concerned **or**,
- The complainant is not satisfied with the reply given to him or redressal action taken by the listed company or an intermediary.

SEBI reserves its right to reject a complaint lodged on SCORES, if the date of cause of action is more than one-year-old and/or the complainant has not taken up the complaint with the concerned entity prior to the said date.

An investor who has lodged the complaint can verify the status by logging in using unique complaint registration number. Every complaint has an audit trail and saved in a central database. If the complaint is successfully resolved the entity is advised to send reply to complainant.

Investors can approach the Online Dispute Resolution mechanism or other appropriate civil remedies at any point of time. In case the complainant opts for Online Dispute Resolution mechanism or other appropriate civil remedies while the complaint is pending on SCORES, the complaint shall be treated as disposed on SCORES.

It is pertinent to note here that at present following types of complaints are not dealt through SCORES:

i. Complaints against the companies which are unlisted/delisted, in dissemination board of Stock Exchanges,

ii. Complaints those are sub-judice i.e., relating to cases which are under consideration by court of law, quasi-judicial proceedings etc.

iii. Complaints falling under the purview of other regulatory bodies viz. RBI, IRDAI, PFRDA, CCI, etc., or under the purview of other ministries viz., MCA, etc.

iv. Complaints against a sick company or a company where a moratorium order is passed in winding up / insolvency proceedings.

v. Complaints against the companies where the name of company is struck off from RoC or a vanishing company as per list published by MCA.

vi. Companies under liquidation / BIFR / etc.

vii. Disputes pending with ODR mechanism under the aegis of MIIs.

Following matters cannot be considered as complaints under SCORES:

a. Complaint not pertaining to investment in securities market

b. Anonymous Complaints (except whistleblower complaints)

c. Incomplete or un-specific complaints

d. Allegations without supporting documents

e. Suggestions or seeking guidance/explanation

f. Not satisfied with trading price of the shares of the companies

g. Non-listing of shares of private offer

h. Disputes arising out of private agreement with companies/intermediaries

i. Matter involving fake/forged documents

j. Complaints on matters not in SEBI purview

k. Complaints about any unregistered/ un-regulated activity

To enhance investor satisfaction on complaint redressal, a one-time 'Review' option is also available under SCORES wherein a complainant, if not satisfied with the extent of redressal of grievance by the concerned listed company/ intermediary/ MII, opts for review of the extent of the redressal, within 15 days from the date of closure of the complaint on SCORES. Thereafter, the complaint shall be escalated to the supervising official of the dealing officer of SEBI.

In order to increase the awareness regarding online grievance redressal mechanisms, all Recognized Stock Exchanges / Depositories / Clearing Corporations are advised to display the following on the home page of their websites and mobile apps.

- Link / option to lodge complaint with them directly.
- Link to SCORES website/ link to download SCORES mobile app

**SCORES 2.0**

In its continuous pursuit of protection of interests of investors in the securities market, SEBI has launched the new version of the SEBI Complaint Redress System (SCORES 2.0) w.e.f. April 01, 2024. The new version of SCORES strengthens the investor complaint redress mechanism in the securities market by making the process more efficient through auto-routing, auto-escalation, monitoring by the 'Designated Bodies and reduction of timelines. The new SCORES system has also been made more user friendly. The website URL for SCORES 2.0 from April 01, 2024 is https://scores.sebi.gov.in.

The salient features of SCORES 2.0 are as follows:

- Reduced and uniform timelines for redressal of investor complaints across the Securities Market i.e. 21 Calendar days from date of receipt of complaint.
- Introduction of auto-routing of complaints to the concerned regulated entity so as to eliminate time lapses, if any, in the flow of complaints.
- Monitoring of the timely redressal of the investors' complaints by the 'Designated Bodies'.

- Providing two levels review system: First review by the 'Designated Body' if the investor is dissatisfied with the resolution provided by the concerned regulated entity. Second review by SEBI if the investor is still dissatisfied after the first review.
- Introduction of auto-escalation of complaint to the next level in case of non-adherence to the prescribed timelines by the regulated entity or the Designated Body as the case may be.
- Integration with KYC Registration Agency database for easy registration of the investor on to SCORES.

Investors can lodge complaints only through new version of SCORES i.e. https://scores.sebi.gov.infrom April 01, 2024.

### 7.2.3 Investor Service Centres (ISCs) of Stock Exchanges

SEBI vide Circular No. SMD/POLICY/CIR-32/97 dated December 03, 1997 advised all stock exchanges to open or maintain atleast one Investor Service Centre (ISC) for the benefit of the investors. Such centres are required to, inter alia, provide counseling service and provide certain basic minimum facilities to the investors. Subsequently, SEBI has mandated Exchanges to open ISCs in metro cities (viz., New Delhi, Mumbai, Chennai and Kolkata), and stock exchanges having nationwide terminals shall open ISCs additionally in Ahmedabad, Hyderabad, Kanpur, Indore, Bangalore, Pune, Jaipur, Ghaziabad, Lucknow, Gurgaon, Patna and Vadodara. In order to reach out to the investors across India, SEBI has advised the stock exchanges to open additional ISCs wherever required; or as specified by the SEBI from time to time. The ISCs can be set up either by one stock exchange or jointly by two or more stock exchanges as per their mutual agreement. SEBI has advised Exchanges to provide certain minimum facilities in ISCs centres. Some of the facilities are given below:

- Four financial daily newspapers with atleast one in the regional language of the place where the ISC is situated.
- A dedicated desktop or laptop with internet connectivity to enable the investors to access various relevant information available in public domain and also to access SEBI's and stock exchange's grievance redressal portals
- Facilities for receiving investor complaints in both physical and electronic form.
- Facilitation desks at all ISCs to assist the investors in the dispute resolution process.
- Arbitration and appellate arbitration facility at all ISCs including video-calling facility to investors for attending their online arbitration (including appellate arbitration) or Grievance Redressal meetings, if any.
- A meeting room for at least 5 to 6 persons and additional sitting space for at least 5 to 6 persons.

- A library of relevant laws, common booklets on various areas of the securities markets, educational materials, etc. for investors. In case of receipt of a request for physical copies of relevant laws, the same shall be provided at a minimal cost.
- A register or database of visitors (including investors) for future correspondence, whenever required.

Other infrastructure facilities such as a telephone, photocopier, printer, scanner, internet access, furniture, etc.

SEBI has directed Stock Exchanges to ensure that Investor Service Center (ISC) officials are trained in market operations, grievance resolution, and the SCORES platform to effectively guide retail participants.

With the introduction of Online Dispute Resolution (ODR) platform and SCORES 2.0, it SEBI has modified the Investor Charter for Stock Exchanges inter-alia detailing the services provided to Investors, Rights of Investors, various activities of stock exchanges with timelines, Dos and DON'T's for Investors, Responsibilities of Investors, Code of Conduct for Stock Exchanges and Grievance Redressal Mechanism.[113]

Mode of filing the complaints –Complaints can be lodged on the Exchange in the following ways:

(i) Through SCORES 2.0

Two Level Review: a) First review done by Exchange. b) Second review done by SEBI.

(ii) Respective Exchange's web portal dedicated for the filing of compliant [link to be provided by Exchange]

(iii) Emails to designated email IDs of Exchange [link to be provided by Exchange]

(iv) Through SMARTODR (https://smartodr.in/login) dedicated for the filing of complaint.

## 7.3 Online Resolution of Disputes in the Indian Securities Market[114] (SMART ODR)

SEBI has notified and put in place an "Online Dispute Resolution process" by establishing a common Online Dispute Resolution Portal (ODR Portal). The ODR portal harnesses online conciliation and online arbitration for resolution arising in the securities markets. SEBI's incorporation of ODR ensures that investors have access to a streamlined process to resolve grievances against listed companies, intermediaries, and market infrastructure institutions.

[113] https://www.sebi.gov.in/legal/circulars/may-2024/investor-charter-for-stock-exchanges_83653.html

[114]https://www.sebi.gov.in/legal/circulars/jul-2023/online-resolution-of-disputes-in-the-indian-securities-market_74794.html & https://www.sebi.gov.in/legal/circulars/aug-2023/corrigendum-cum-amendment-to-circular-dated-july-31-2023-on-online-resolution-of-disputes-in-the-indian-securities-market_74976.html

### 7.3.1 Investors and Listed Companies/Specified Intermediaries/Regulated entities under the ambit of ODR

Disputes between Investors/Clients and listed companies (including their registrar and share transfer agents) or any of the specified intermediaries/regulated entities in securities market (as specified below) arising out of latter's activities in the securities market, will be resolved by harnessing online conciliation and/or online arbitration as specified in the SEBI circular on ODR. Listed companies / specified intermediaries / regulated entities OR their clients/investors (or holders on account of nominations or transmission being given effect to) may also refer any unresolved issue of any service requests / service-related complaints[115] for due resolution by harnessing online conciliation and/or online arbitration as specified in SEBI circular.

Specified Intermediaries and Regulated Entities List of securities market intermediaries / regulated entities against whom investors may invoke the ODR process:

1. AIFs –Fund managers
1A. Banker to an Issue and Self-Certified Syndicate Banks
2. CIS –Collective Investment management company
2A. Commodities Clearing Corporations
3. Depository Participants
4. Investment Advisors
5. InvITs -Investment Manager
5A. Merchant Bankers
6. Mutual Funds -AMCs
7. Portfolio Managers
8. Registrars and Share Transfer Agents
9. REITs –Managers
9A. Research Analyst
10. Stock brokers (including Online Bond Platforms & Online Bond Platform Providers)

Disputes between institutional or corporate clients and specified intermediaries / regulated entities in securities market can be resolved, at the option of the institutional or corporate clients like Custodian, Credit Rating Agency, Clearing Corporations etc. :

a. in accordance with this circular and by harnessing online conciliation and/or online arbitration as specified in this circular, OR

[115] Service-related complaints shall include non-receipt/ delay of account statement, non-receipt/ delay of bills, closure of account/branch, technological issues, shifting/closure of branch without intimation, improper service by staff, freezing of account, alleged debit in trading account, contact person not available, demat account transferred without permission etc.

b. by harnessing any independent institutional mediation, independent institutional conciliation and/or independent arbitration institution in India. The seat and venue of mediation, conciliation and/or arbitration shall be in India and can be conducted online.
Disputes between Market Infrastructure Institutions (MIIs) and its constituents which are contractual in nature shall be included in the framework at a future date as may be specified while expressly excluding disputes/appeals/reviews/challenges pertaining to the regulatory, enforcement role and roles of similar nature played by MIIs.

**7.3.2 Empanelment of ODR Institution**

An MII shall empanel one or more ODR Institutions as a service provider and enter into relevant agreements with such ODR Institution(s) in accordance with guidelines issued by the SEBI. MII should ensure that the primary/first ODR Institution to be empaneled with it, is not empaneled as the primary/first ODR Institution with any other MII. An MII shall collect requisite information of a ODR Institution desirous of being empaneled for providing ODR services for the Indian Securities Market. Such information shall include: copies of registration certificate, memorandum of association and articles of association/ constitutional documents, rules governing conciliation and arbitration, PAN, Legal Entity Identifier number, composition of its board of directors, governing bodies and advisory councils, if any, and details of its shareholders and investors, and list of its authorized officials / signatories. An ODR Institution empaneled by an MII should be/become a member of association/trade body having as its members MII empaneled ODR Institutions for the Indian Securities Market.

**7.3.3 Introduction of the common Online Dispute Resolution Portal**

- The MIIs shall, in consultation with their empanelled ODR Institutions, establish and operate a common Online Dispute Resolution Portal ("ODR Portal"). The MIIs will make joint efforts to develop and operationalize the ODR Platform
- The MIIs shall enter into an agreement amongst themselves, which will, inter alia, outline the nature of their responsibilities, the cost of development, operating, upgradation, maintenance and for inspection and/or audit of the ODR Platform.
- SEBI shall from time to time, undertake inspection in order to ensure proper functioning of ODR Portal and MIIs shall provide complete cooperation to SEBI in this regard.
- Each MIIs will identify and empanel one or more independent ODR Institutions which are capable of undertaking time-bound online conciliation and/or online arbitration (in accordance with the Arbitration and Conciliation Act, 1996 and any other applicable laws) that harness online/audio-video technologies and have duly

qualified conciliators and arbitrators. ODR Portal shall establish due connectivity with the SEBI SCORES portal / SEBI Intermediary portal.

- All the MIIs shall participate on the ODR Portal and provide investors/clients and listed companies, their specified intermediaries access to the ODR portal for resolution of disputes between an investor/client and listed companies and the specified intermediaries / regulated entities in the securities market, through time bound online conciliation and/or online arbitration**.**
- All Market participants in the securities market shall enroll on the ODR Portal within the timelines specified in SEBI circular and shall be deemed to have been enrolled on the ODR Portal at the end such specified timeline.

**7.3.4 Initiation of the dispute resolution process**

An investor/client shall first take up his/her/their grievance with the Market Participant by lodging a complaint directly with the concerned Market Participant. If the grievance is not redressed satisfactorily, the investor/client may, in accordance with the SCORES guidelines, escalate the same through the SCORES Portal in accordance with the process laid out therein. After exhausting these options for resolution of the grievance, if the investor/client is still not satisfied with the outcome, he/she/they can initiate dispute resolution through the ODR Portal.

Alternatively, the investor/client could initiate dispute resolution through the ODR Portal if the grievance lodged with the concerned Market Participant was not satisfactorily resolved or at any stage of the subsequent escalations mentioned in the above paragraph (prior to or at the end of such escalation/s). However, one perquisite to file a complaint in SMART ODR is that the investor has to first take up the complaint with the intermediaries before opting for ODR.

Upon receipt of complaint on SMARTODR portal, the relevant MII will review the matter and endeavour to resolve the matter between the Market Participant and investor within 21 days. If the matter could not be amicably resolved, then to the matter shall be referred for conciliation.

The concerned Market Participant may also initiate dispute resolution through the ODR Portal after having given due notice of at least 15 calendar days to the investor/client for resolution of the dispute which has not been satisfactorily resolved between them.

**7.3.5 ODR Portal and Allocation System**

The ODR Portal shall have the necessary features and facilities to, inter alia, enroll the investor/client and the Market Participant, and to file the complaint/dispute and to upload

any documents or papers pertaining thereto. Along with a complaint the claimant may need to submit necessary document / record which include:

- Statement explaining the dispute and the nature of transactions, separating delivery-based transaction and squared-off transactions.
- Contract Notes pertaining to the transaction in dispute.
- Bills issued/received by the applicant.
- Copy of the accounts statement given by broker.
- Documents pertaining to receipt/delivery of shares.
- Any other documents in support of the claim.
- An accurate list of the documents produced.
- PAN/ GIR No. of the applicant.
- Certified copy of the Balance Sheet of the applicant showing the dues.
- Copy of acknowledgement of the latest Income Tax Return.
- Margin Statement
- Member Constituent Agreement
- Risk Disclosure Document etc.

The ODR portal shall also have a facility to provide status updates on the complaint/dispute which would be obtained from the ODR Institutions.

A complaint/dispute initiated through the ODR Portal will be referred to an ODR Institution empaneled by a MII and the allocation system on a market-wide basis will be a round-robin system to govern the allocation of each such dispute among all such empaneled ODR Institution/s subject that for an initial period. References to ODR Institutions shall be made after a review of such complaint/dispute by the relevant MII with the aim of amicable resolution and which review shall be concluded within 21 calendar days.

**7.3.6 Conciliation**

- The ODR Institution that receives the reference of the complaint/dispute shall appoint a sole independent and neutral conciliator from its panel of conciliators. Such conciliator shall have relevant qualifications or expertise and should not be connected with or linked to any disputing party. MIIs shall ensure that appropriate measures are put in place regarding appointment of conciliators by the ODR Institutions.
- Such conciliator shall conduct one or more meeting/s for the disputing parties to reach an amicable and consensual resolution within 21 calendar days (unless extended for a maximum period of 10 calendar days by consent of the disputing parties to be recorded in writing/electronically) from the date of appointment of conciliator by the ODR Institution, which shall do so within 5 days of receipt of reference of the complaint/dispute by the ODR Institution.

If the process of conciliation is successful, the same shall be concluded by a duly executed settlement agreement between the disputing parties. Such an agreement shall be executed and stamped through an online mode, as permissible in law.

In case the matter is not resolved through the conciliation process within the 21 calendar days (or within the extended period of 10 calendar days, extended by consent of the disputing parties):

a. the conciliator should ascertain the admissible claim value of the complaint/dispute that the conciliator determines is payable to the investor/client and notify the disputing parties as well as the ODR Institution and the MII of the same.
b. An investor/client may pursue online arbitration (which will be administered by the ODR Institution which also facilitated the conduct of conciliation) on or after the conclusion of a conciliation process.
c. In case the Market Participant wishes to pursue online arbitration, then the Market Participant must deposit 100% of the admissible claim value with the relevant MII prior to initiation of the online arbitration.

In case the Market Participant fails to deposit the amount then they may not initiate online arbitration, and they may also face consequences as determined necessary or appropriate by the Stock Exchange. On an application made by the investor/client in this behalf to the relevant MII, the MII may, from the deposit received, release such amount to the investor/client not exceeding Rs 5,00,000/- (Rupees Five lakhs) or such sum as may be specified from time to time. On or before release of the said amount to the investor/client, the MII shall obtain appropriate undertaking/ indemnity / security in such form, manner and substance from the investor/client to ensure return of the amount so released, in case the arbitration proceedings are decided against the investor/client.

**7.3.7 Fees and Charges**

The fees for conciliation process as stipulated in the SEBI circular may be borne by the MIIs and will be recoverable by them from the concerned Market Participant against whom the complaint/dispute is raised. Such fees shall be borne directly by the concerned Market Participant if it is initiating the dispute process. The Market Participant shall not shift the incidence of such fees to the investor/client at any time.

***Unsuccessful Conciliation:*** In the event the disputing parties are not able to arrive at a settlement within the stipulated time (or such extended period as agreed to by them) it shall be said to be unsuccessful conciliation.

***Late Fees:*** Initiation of conciliation process after six months from the date of transaction/dispute arising will require payment of Rs 1000/- by the initiator of the

complaint/dispute (whether such initiator be the investor/client or the Market Participant) and shall be collected by the MIIs and applied as specified by the Board from time to time.

### 7.3.8 Arbitration

Arbitration, which is a quasi-judicial process, is an alternate dispute resolution mechanism prescribed under the Arbitration and Conciliation Act, 1996.

If conciliation is unsuccessful, an investor may initiate online arbitration by paying the necessary fees, and the stock broker is required to participate. The stock broker must deposit 100% of the admissible claim value with the relevant MII and pay all applicable fees within 10 days of the investor starting arbitration. If the broker initiates arbitration, they must inform the ODR Institution within 10 days of conciliation ending and deposit the full claim value within an additional 5 days. Non-compliance can result in stringent action against broker.

| Claim Amount | No. of Arbitrator |
|---|---|
| Upto Rs. 30 Lacs | Sole independent and neutral arbitrator. Such arbitrator shall have relevant qualifications or expertise and should not be connected with or linked to any disputing party. |
| Above Rs. 30 Lacs | Arbitral Tribunal consisting of three Arbitrators. |

Other details of arbitration is given below:

- Value of claim and/or counter-claim being in excess of Rs 1,00,000/- (Rupees One Lakh), the Sole Arbitrator or Arbitral Tribunal shall conduct one or more hearing/s and pass the arbitral award within 30 calendar days (or such other period as the Board may specify) of the appointment in the matter.
- When the value of claim and/or counter-claim is Rs 1,00,000/- (Rupees One Lakh) or below (or such other sum as the SEBI may specify from time to time), the Sole Arbitrator shall conduct a document-only arbitration process and pass the arbitral award within 30 calendar days (or such other period as the Board may specify) of the appointment in the matter[116].However, the arbitrator, for reasons to be recorded in writing/electronically , may grant a hearing to the parties to the dispute. The Sole Arbitrator or Arbitral Tribunal shall be at liberty to extend such time for disputes exceeding claims and/or counterclaims of Rs 1,00,000/- (Rupees One Lakh) (or such other sum as the Board may specify from

[116] If parties to the dispute do not provide any representation in the arbitral proceedings, the arbitrator may pass an ex-parte order after giving a notice of 7 calendar days to the concerned non-cooperative party(ies).

time to time), upto a further period of 30 calendar days (or such other period as the Board may specify) and for reasons to be recorded in writing/electronically, when the matter requires detailed consideration. The Sole Arbitrator or Arbitral Tribunal may, having regard to the nature of the claim and/or counterclaim, provide interim relief as may be required for reasons to be recorded after affording hearing to the parties to the dispute. The parties may make an application under the relevant section of the Arbitration and Conciliation Act, 1996 for correction/rectification of the award.

Upon the conclusion of the arbitration proceedings and issuance of the arbitral award, subject to the terms of the arbitral award, when such arbitral award requires payment of any amount by the Market Participant or performance by it of a certain nature, then such payment shall be made by the Market Participant within a period of 15 calendar days from the date of the arbitral award (unless such award requires payment sooner), and/or performance within such period as specified by the arbitral award. MII shall provide necessary assistance to the investor/client for enforcement of the arbitral award.

Upon the issuance/pronouncement of the arbitral award, the party against whom order has been passed, will be required to submit its intention to challenge the award under Section 34 of the Arbitration Act within 7 calendar days in the ODR Portal for onward notification to the party/ies in whose favour the arbitral award has been passed and the relevant MII. Further, in the course of such a challenge, if a stay is not granted within 3 months from the date of the receipt of award, complete adherence to the terms of the arbitral award must be done.

If the Market Participant wishes to challenge such an arbitral award, then the Market Participant must deposit 100% of the amounts payable in terms of the arbitral award with the relevant MII prior to initiation of the challenge. In case the specified intermediary/regulated entity fails to deposit the amount then they may also face consequences as determined necessary or appropriate by the Stock Exchange. The MII shall also monitor the due compliance by the Market Participant with the terms of the arbitral award/judgement of the appellate forum.

**7.3.9 Form of Proceedings for Conciliation and Arbitration**

The ODR Institutions shall conduct conciliation and arbitration in the online mode, enabling online/audio-video participation by the investor/client, the Market Participant and the conciliator or the arbitrator as the case may be. The investor/client may also participate in such online conciliation and arbitration by accessing/utilizing the facilities of Investor Service Centers (ISCs) operated by any of the MIIs. The venue and seat of the online proceedings shall be deemed to be the place:

a) In case of disputes between investor/client and listed companies (including their registrar and share transfer agents) or any of the specified intermediaries / regulated entities in securities market: where the investor resides permanently or, where the investor is not an individual, the place where it is registered in India or has its principal place of business in India, as provided in the relevant KYC documents

b) In case of disputes between institutional or corporate clients and specified intermediaries / regulated entities in securities market:
(i) where the institutional or corporate clients has its registered in India or has its principal place of business in India, as provided in the relevant KYC documents, and
(ii) if in case the institutional or corporate client is not registered in India or does not have its principal place of business in India, then the place where the specified intermediaries / regulated entities in securities market as specified in Schedule B has its registered in India or has its principal place of business in India or
(iii) such court of competent jurisdiction in India as the institutional or corporate clients and specified intermediaries / regulated entities in securities market may agree upon.

**7.3.10 Arbitration Fees**

The fees for the arbitration process will be based on the claim amount. There will be separate fee for arbitrator and ODR institution. The fee is collected by ODR institution.

***Late Fees:*** Arbitration initiated after one month of failure of conciliation and upto six months, the fees payable would be double of the non-refundable fees. Arbitration initiated after six months by a Market Participant will require payment of, additional fee of 50% of the fees, applicable per additional month of delay and which shall be on non-refundable basis.

**7.3.11 Responsibilities of Market Participants – Under ODR**

All agreements, contractual frameworks or relationships entered into by Market Participants with investors/clients in the Indian Securities market presently existing or entered into hereafter shall stand amended or be deemed to incorporate provision to the effect that the parties agree to undertake online conciliation and/or online arbitration by participating in the ODR Portal and/or undertaking dispute resolution in the manner specified in this Circular.

The Market Participants shall promptly attend to all complaints or disputes raised by its investors or clients in accordance with applicable SEBI rules, regulations and circulars. Communications shall clearly specify, the availability of the SCOREs portal and the ODR

Portal to the investor/client and that the same could be accessed by such investor/client if unsatisfied with the response (or the lack thereof) of the Market Participant.

The Market Participants shall duly train their staff in attending to complaints/disputes and in handling the references arising from the SCOREs portal or the ODR Portal, and in participating in online conciliation and arbitration. Due cooperation and coordination with the MIIs and with the ODR Institutions shall be ensured by the Market Participants.

The SEBI may request the Market Participants to maintain such level of interest-free deposit with the MIIs or with the concerned designated body identified vide the revised SCOREs guidelines and shall be such sums that it is considered necessary and appropriate for honoring of any arbitral awards or amounts payable pending initiation of arbitration or challenge to an arbitral award.

The circular also provides details of Empanelment and Training of the Panel of Conciliator and Arbitrators & Roles and Responsibilities of MIIs.

**ODR Flow**

| | | |
|---|---|---|
| 1 | Online Dispute Resolution (ODR) platform for online Conciliation and Arbitration | If the Investor is not satisfied with the resolution provided by the Market Participants, then the Investor has the option to file the complaint/ grievance on the SMARTODR platform for its resolution through online conciliation or arbitration |
| 2 | Steps to be followed in ODR for Review, Conciliation and Arbitration | • Investor to approach Market Participant for redressal of the complaint.<br>• If investor is not satisfied with the response of Market Participant, he/she has either of the following 2 options:<br>May escalate the complaint on the SEBI SCORES portal. (In this scenario, the above steps shall prevail)<br>May also file a complaint on the SMARTODR portal for its resolution through online conciliation and arbitration.<br>• Upon receipt of the complaint on the SMARTODR portal, the relevant MII will review the matter and endeavour to resolve the matter between the Market Participant and the investor within 21 days.<br>• If the matter could not be amicably resolved, then the matter shall be referred for conciliation. |

| | | |
|---|---|---|
| | | • During the conciliation process, the conciliator will endeavour for an amicable settlement of the dispute within 21 days, which may be extended by 10 days by the conciliator with consent of the parties to the dispute.<br>• If the conciliation is unsuccessful, then the investor may request to refer the matter for arbitration.<br>• The arbitration process is to be concluded by the arbitrator(s) within 30 days, which is extendable by 30 days with the consent of the parties to dispute.<br>• If the parties are not satisfied with the arbitration award, there is an option to file legal recourse u/s 34 of the Arbitration and Conciliation Act, 1996 |

**Handling of Investor's claims / complaints in case of default of a Trading Member / Clearing Member (TM/CM)**

**Default of TM/CM**

Following steps are carried out by Stock Exchange for benefit of investor, in case stock broker defaults:

• Circular is issued to inform about declaration of Stock Broker as Defaulter.

• Information of defaulter stock broker is disseminated on Stock Exchange website.

• Public Notice is issued informing declaration of a stock broker as defaulter and inviting claims within specified period.

• Intimation to clients of defaulter stock brokers via emails and SMS for facilitating lodging of claims within the specified period.

Following information is available on Stock Exchange website for information of investors:

• Norms for eligibility of claims for compensation from IPF.

• Claim form for lodging claim against defaulter stock broker.

• FAQ on processing of investors' claims against defaulter stock broker.

• Provision to check online status of client's claim.

• Standard Operating Procedure (SOP) for handling of Claims of Investors in the Cases of default by TMs

• Claim processing policy against Defaulter/Expelled TMs.

• List of Defaulter/Expelled TMs and public notice issued.

In order to bring about transparency in the Investor Grievance Redressal Mechanism, it has been decided that all the Stock Exchanges / Depositories / Clearing Corporations shall

disclose on their websites, the data on complaints received against them and redressal thereof, latest by 7th of succeeding month, as per the format specified by SEBI.

## 7.4 Investor Protection Fund

The Central Government, vide notification No. F. No. 14/4/SE/85 dated August 22, 1985, has stipulated the setting up of the Investor Protection Fund (IPF) by Stock Exchanges. This fund should take care of legitimate investment claims which are not of speculative nature of the clients of defaulting member(s). The Investor's Protection Fund is a fund established and maintained by the Exchanges with an aim to protect the interests of the clients of the trading members of the Exchange, who may have been declared defaulters or who may have been expelled, under the provisions of the Rules, Bye-laws and Regulations of the Exchange. The Investor Protection Fund/Customer Protection Fund (hereinafter referred to as IPF/CPF) shall be administered by way of a Trust created for this purpose.

SEBI has provided Comprehensive guidelines for Investor Protection Fund and Investor Services Fund at Stock Exchanges and Depositories[117]. Salient features of the circular are given below. For additional information candidates may refer to the SEBI circular.

1. All stock exchanges and depositories shall establish an IPF. The IPF of the stock exchange and depository shall be administered through separate trusts created for the purpose.
2. The following contributions shall be made by the Stock Exchange to the IPF:

   a) 1% of the listing fees received, on a quarterly basis.
   b) 100% of the interest earned on the 1% security deposit kept by the issuer companies at the time of the offering of securities for subscription to the public, immediately on refund of the deposit.
   c) Penalty collected by stock exchanges from Trading Members(TMs) for deficiency in modification of client code, if any.[118]
   d) Penalty collected by stock exchanges from TMs for default in pay-in for certain trades during periodic call auction for Illiquid scrips, if any., [119].
   e) Penalties collected by stock exchanges from their listed companies for non-compliance with various requirements of the SEBI (Listing Obligation and Disclosure Requirements) Regulations 2015.[120] .

[117]https://www.sebi.gov.in/legal/circulars/may-2023/comprehensive-guidelines-for-investor-protection-fund-and-investor-services-fund-at-stock-exchanges-and-depositories_71925.html
[118] SEBI Circular No.CIR/DNPD/6/2011 dated July 05, 2011
[119] SEBI Circular No. CIR/MRD/DP/ 6/2013 dated February 14, 2013
[120] SEBI Circular no. SEBI/HO/CFD/CMD/CIR/P/2020/12 dated January 22, 2020

f) Penalty collected from TMs for default in pay-in by an investor in an Offer For Sale (OFS)transaction –10% of the order value.[121] .

g) Contribution towards the IPF based on the transaction charges collected from the members of the exchange, as per policy of the respective stock exchange.

h) At least 70% of interest or income received out of any investments made from the IPF.

i) Any other contribution as may be specified by SEBI from time to time.

3. The amount in IPF and any interest or income generated from the IPF of the stock exchanges shall be utilized To meet the legitimate investment claims of the clients of the defaulting TMs and to pay interim relief to investors, if any, in terms of paragraph-2(D) of circular No. SEBI/HO/MRD1/ICC1/CIR/P/2021/625dated September 02, 2021, if any.
4. Interest or income received out of any investments made from the IPF : At least 70% of interest or income from IPF received every year shall be ploughed back to IPF; 25% can be utilised for promotion of investor education and investor awareness.
5. The stock exchanges and depositories shall conduct half-yearly review (by end of March and September every year) to ascertain the adequacy of the IPF corpus. In case the IPF corpus is found to be inadequate, the same shall be enhanced appropriately.
6. The claims received against the defaulter TMs during the specified period shall be eligible for compensation from the IPF. Where the clients have dealt through the authorized persons of the defaulting TM, registered with the stock exchange, such clients will also be eligible for claims against the defaulting TM for compensation from the IPF. The claims of the investors or clients arising out of speculative transactions shall not be eligible for compensation from the IPF.
7. Any claim received after three years from the date of expiry of the specified period may be dealt with as a civil dispute.
8. The stock exchanges shall fix suitable per investor compensation limits, in consultation with the IPF Trust and SEBI.
9. The Stock Exchanges shall ensure that once a TM has been declared defaulter, the claim(s)shall be placed before the Member Committee (MC)for sanction and ratification. MC's legitimate claims shall be sent to the IPF Trust for immediate disbursement of the amount.
10. The IPF Trust shall disburse the amount of compensation from the IPF to the investor and such a compensation shall not be more than the maximum amount fixed for a single claim of an investor.

[121] SEBI Circular No. SEBI/HO/MRD/MRD-PoD-3/P/CIR/2023/10 dated January 10, 2023

11. The Stock Exchange will disclose the corpus of the IPF on its website and update the same on a monthly basis. Also disseminate the policy on processing investor claims from IPF.
12. In order to prevent the possibility of identical claims of clients of defaulter trading members being paid by multiple exchanges, stock exchanges shall share amongst themselves relevant data w.r.t. clients of defaulter/disabled members within 10 days from the date of disablement in order to identify common clients of such members. Further, stock exchanges shall also at the time of disbursing the claims of the clients of defaulting members share the details of the client viz. PAN, UCC, amount disbursed with the other exchanges.

**7.4.1 Investor Services Fund of Stock Exchanges**

The stock exchange shall set aside at least 20% of the listing fees received for ISF for providing services to the investing public. In order to have better management and control on the contributions and utilization of ISF corpus, supervision of the same will rest with the Regulatory Oversight Committee. ISF can be utilized only for promotion of investor education and investor awareness programs through seminars, lectures, workshops, publications (print and electronic media), training programs etc. aimed at enhancing securities market literacy and promoting retail participation in securities market;

**Chapter 7 : Sample Questions**

1. Who is the backbone of the securities market?
   (a) Stock Exchanges
   (b) Trading Members
   **(c) Investors**
   (d) Regulators

2. Arbitration aims at _____ legal resolution for the disputes.
   (a) Slower
   **(b) Quicker**
   (c) Routine

3. Arbitration for claims up to _____ is decided by a sole arbitrator.
   **(a) Rs. 30 Lakh**
   (b) Rs. 5 Lakh
   (c) Rs. 20 Lakh
   (d) Rs. 50 Lakh

4. Investor protection fund is established and maintained by _____.
   **(a) Stock Exchange**
   (b) Association of investors
   (c) Depositories
   (d) Stock Broker Association

5. Online arbitration is administered by _____.
   (a) Association of investors
   (b) Depositories
   (c) Stock Broker Association
   **(d) ODR Institution**

# CHAPTER 8: OTHER SERVICES PROVIDED BY BROKERS

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about the services provided by the trading members:

- IPO Applications
- Trading of Mutual Fund Units
- Portfolio Management Service
- Research Reports & Investment Advise
- Depository Services
- Margin Trading
- Internet Based Trading etc.

## 8.1 Introduction

The brokers provide a number of other services to their clients, like facilitating application in Initial Public Offerings (IPO), trading of Mutual Fund Units, Portfolio Management Services, etc. Some of the other services provided by them are enumerated here. However, for all the other services, the brokers need to be separately registered with SEBI.

Typically, big stock brokers have converted themselves into financial services companies. They provide investment options in equities, derivatives, commodities, IPO, mutual funds, depository services, portfolio management services and insurance. They also offer wealth management services for high net worth individuals (HNIs). They also have branches all over the country and provide services via internet or telephone. Licenses and certifications have to be obtained for each of the services offered by the stockbrokers.

They offer various types of investment products like different schemes of investment and different types of portfolios.

Normally, a stock broker's outlet offers these facilities:

- Investment advice & Research reports and market review
- Depository services
- Direct Market Access (DMA)
- Mobile trading & Smart Order Routing (SOR)
- Algorithmic trading

- IPOs & Mutual Funds Distribution
- Internet-based Online Trading (IBT)
- Margin funding

In the subsequent sections we try to briefly discuss in brief the other services as provided by the brokers.

## 8.2 IPO Applications

An IPO is the process by which a company goes public, i.e., offers its shares to the public for sale for the first time. Electronic trading through broking firms has made investing in IPOs very simple. Once the account is opened with the broker, the investor has to call or login and apply for the IPO. The IPO process is facilitated by brokers as their system is connected with the stock Exchanges main IPO system and online uploading of forms is carried out. Thus, at any given time, the online status is available on the stock Exchanges. This process is facilitated by the stock brokers.

The Book Running Lead Manager will give list of trading members who are appointed as syndicate/sub-syndicate members to participate in the book building process to the Exchange.[122] Exchange provides platform to trading members to submit the IPO application online. To enable on IPO platform, member has to comply with the registration procedure specified by Exchanges from time to time. As and when valid offers are received by the system of the stock Exchange, they are first numbered, time stamped, and stored in the book. Each offer has a distinctive offer number and a unique time stamp on it. All the offers placed in the system will remain outstanding till the last day of the book building process. Trading Members can modify/cancel all the offers placed in the system from the start till the last day of the book-building process within the SEBI guideline.

SEBI has introduced a facility called **Application Supported by Blocked Amount (ASBA)** in the Primary market for investors. In ASBA the application money remains blocked in the investor's account till finalization of basis of allotment in the issue. The application money to the extent of allotment value is debited from the bank account only if the investors application is selected for allotment after the basis of allotment is finalized and the non-allotted amount is unblocked. As per SEBI circular no CIR/CFD/POLICY CELL/11/2015 dated November 10, 2015. All the investors shall mandatorily use only Application Supported by Blocked Amount (ASBA) facility for all issues opening from 01 January 2016 onwards. SEBI

[122]The lead merchant bankers appointed by the Issuer Company are referred to as the Book Running Lead Managers. The names of the Book Running Lead Managers are mentioned in the offer document of the Issuer Company.

further advised that, the ASBA applications in public issues shall be processed only after the application monies are blocked in the investor's bank accounts. Accordingly, all intermediaries / market infrastructure institutions are advised to ensure that appropriate systemic and procedural arrangements are made within three months from the date of issuance of this circular.[123]

To further streamline the process of IPO, SEBI had decided the use of Unified Payment Interface (UPI) as a payment mechanism with Application Supported by Block Amount (ASBA) for application in public issues by retail investors through intermediaries (Syndicate members, Registered Stock Brokers, Registrar and Transfer agent and Depository Participants).[124] SEBI vide circular dated April 05, 2022, decided that all Individual Investors applying in Public issues where the application amount is upto 5 Lakhs shall use UPI and shall also provide their UPI ID in the bid-cum-application form submitted with any of the entities mentioned herein below:

i. a syndicate member
ii. a stock broker registered with a recognised stock exchange (and whose name is mentioned on the website of the stock exchange as eligible for this activity) ('broker')
iii. a depository participant ('DP') (whose name is mentioned on the website of the stock exchange as eligible for this activity)
iv. a registrar to an issue and share transfer agent ('RTA') (whose name is mentioned on the website of the stock exchange as eligible for this activity)

The process increases efficiency, eliminates the need for manual intervention at various stages, and thereby reduces the time duration from issue closure to listing by up to 3 working days. Considering the time required for making necessary changes to the systems and to ensure complete and smooth transition to UPI payment mechanism, it is proposed to be introduced in a phased manner. The T+3 timeline for listing after the closure of public issue will be applicable for all public issues opening on or after December 1, 2023.

In order to streamline and align the process of applying in the public issue of debt securities, non-convertible redeemable preference shares, municipal debt securities and securitised debt instruments with that of public issue of equity shares and convertibles, SEBI vide circular dated September 24, 2024, has decided that all individual investors applying in public issues of such securities through intermediaries (viz. syndicate members, registered stock brokers, registrar to an issue and transfer agent and depository participants), where the application amount is upto Rs. 5 Lakh, shall only use UPI for the purpose of blocking of funds and provide his/ her bank account linked UPI ID in the bid-cum-application form submitted with intermediaries.

[123]https://www.sebi.gov.in/legal/circulars/may-2022/processing-of-asba-applications-in-public-issue-of-equity-shares-and-convertibles_59338.html

[124] vide Circular no SEB/HO/CFD/DIL2/CIR/P/2018/138 dated November 01, 2018

Further, SEBI vide circular dated October 18, 2024, clarified that investors may continue to submit the bid-cum application form online using the facility of linked online trading, demat and bank account (3-in-1 type accounts) for making application in public issue of debt securities, non-convertible redeemable preference shares, municipal debt securities and securitised debt instruments.

Candidates also refer SEBI circular "Adoption of Standardised, Validated and Exclusive UPI IDs for Payment Collection by SEBI Registered Intermediaries from Investors" dated June 11, 2025.

## 8.3 Trading of Mutual Fund Units

The client can invest in different mutual fund schemes online or through phone, availing of the tele-services offered by the trading members. The Exchanges provides platform (e.g. Mutual Fund Service System of NSE and BSE Star MF) to trading member and mutual fund distributors for trading in open ended mutual fund scheme. The trading members who are AMFI Registration Number (ARN) holders and have passed the NISM certification examination are permitted to participate in the trading of the mutual funds units through the exchange trading platform. Further, eligible members would have to register as distributor with the mutual fund company. Apart from brokers, mutual fund distributors registered with AMFI who are permitted by the stock exchanges can also participate in this process. Hence, eligible members would be able to place orders only in respect of Mutual Fund Companies where they have registered as distributor. These members/brokers have to apply to the stock exchange and comply with the various SEBI and the Exchange regulations as notified from time to time. Regulation 4 (g) of SEBI (Investment Advisers) Regulations, 2013, stock brokers are required to comply with general obligations and responsibilities specified in Chapter III of SEBI (Investment Advisers) Regulations, 2013, which, inter-alia, provide that client level segregation of advisory and distribution activities needs to be ensured at the entity and group level.

Asset Management Companies (AMC) desirous of providing this alternate mechanism through Exchange platform to their potential customers shall enter into an agreement with the Exchange/Clearing Corporation. AMC shall notify schemes which they wish to permit on the Mutual Fund platform.

The stock broker shall not be allowed to place an order for the client if registration details of the client are not maintained. The user can modify/ delete client registration already maintained subject to certain restrictions. A bulk upload facility is also available to set up client registration. A client is registered as an individual client in client registration process described above. However, depository accounts can be maintained in joint accounts.

The Exchange system facilitate purchase, redemption, SIP etc. for MF schemes. The stock broker can declare upfront whether the subscription/redemption request would be settled in physical mode or depository mode. The stock broker can request for fresh or additional subscription. For additional subscription in physical mode the folio number would be mandatory. If the DP Settlement is in depository mode, it is mandatory for the stock broker to enter depository details. The user must enter depository ID and client beneficiary ID available in DP master.

Following some of the additional facilities are provided by the stock exchanges to the brokers along with order entry:

- The facility to submit the bulk orders using offline order entry facility.
- The facility to take online backups of orders entered by the user for the day.
- The facility to print the confirmation slips either online or offline.

SEBI vide its various circular[125] has issued guideline for "Discontinuation of usage of pool accounts for transactions in units of Mutual Funds on the Stock Exchange Platforms". Based on the SEBI guideline and Clearing Corporations notification, please note the following important points with regards to transaction in Mutual Funds through Stock Exchanges.

- SEBI has advised member that pooling of funds and/or units by stock brokers / clearing members in any form or manner shall be discontinued for mutual fund transactions.
- Funds pay-in is directly received by the clearing corporation from the investor account and funds pay-out is directly made to the investor account. Pay-in / pay-out of funds shall not be handled by the stock brokers / clearing members.
- Funds can be transferred to the clearing corporation account in different manner such as net banking, NEFT, RTGS, UPI etc. Physical / E-mandate mandates can be registered in favour of the Clearing corporation. Funds shall be debited from the client account on the settlement day.
- Processing of orders is subject to the successful debit of funds and receipt of MIS from payment aggregators. Funds should be received by the clearing corporation within 5 working days of orders being placed.

[125]https://www.sebi.gov.in/legal/circulars/oct-2021/discontinuation-of-usage-of-pool-accounts-for-transactions-in-units-of-mutual-funds-on-the-stock-exchange-platforms_53104.html, https://www.sebi.gov.in/legal/circulars/mar-2022/discontinuation-of-usage-of-pool-accounts-for-transactions-in-the-units-of-mutual-funds-two-factor-authentication-2fa-for-redemption-and-other-related-requirements-extension-of-timeline_57471.html https://www.sebi.gov.in/legal/circulars/mar-2022/discontinuation-of-usage-of-pool-accounts-for-transactions-in-the-units-of-mutual-funds-clarifications-with-respect-to-circulars-dated-october-4-2021_56887.html

- The CC permits a single payment for multiple orders, provided the total payment amount equals or exceeds the sum of all orders. If the payment amount exceeds the total order value, the excess amount will be refunded.
- For both demat and non-demat mode transactions, the units shall be credited and debited directly to/from the investors' demat account/ folio account without routing it through the pool account of the stock brokers / clearing members. However, for redemption of units held in dematerialised mode, the practice of issuance of Delivery Instruction Slip ('DIS') (physical or electronic) to the Depository Participant to debit the units for delivery to clearing corporation may continue.
- Clearing Corporation shall initiate refund for funds received but could not be settled with AMC within a time period specify by the CC from time to time.

All requests for subscription and redemption are settled on an individual basis and only to the extent of the funds/units received from the registered accounts of clients. Clear funds should be available by the cut off time (decided based on the category of scheme) in the designated account of the CCs for processing the order on the same day. For demat transactions, the units shall be credited to the investors' demat account by clearing corporation based on the allotment information provided by the RTA and the depository pay-in files. For non-demat transactions, the units shall be credited to and debited directly from the folio account by RTA. The securities/units pay-out is done on a T+0 basis for liquid funds and a T+1 basis for other funds, subject to the availability of funds within the cut-off time. Securities pay-in for mutual fund units for redemption is done on the T+0 day within the cut-off time specified by the CC and is conducted for units in dematerialized form only by clearing corporation. For demat transactions, the funds pay-out shall be credited to the bank account of the client of the Participant by the Clearing Corporation. The pay-out of funds shall be released from T+1 to T+8 day as per scheme category and timelines stipulated from time to time. For non-demat transactions, the funds pay-out shall be credited directly by the AMC/RTA to the client bank account registered with the RTA.

### 8.4 Portfolio Management Service

Many stock brokers also offer Portfolio Management Services (PMS) to their clients. For this, a separate PMS license has to be obtained by them from SEBI. This is normally offered to the High Net worth Individuals (HNIs). In this kind of service, the stock broker makes the investment decision on behalf of the client and manages his portfolio. The portfolio manager decides the mix of securities that the investor will invest in. Portfolio is updated with the new stocks replacing existing stocks as and when required to optimize performance. Apart from portfolio management, the stock brokers also offer advice on managing the client's portfolio depending upon the client's needs. Based on this advice, the client can make the investment decisions.

As per SEBI (Portfolio Managers) Regulation, 2020 , “portfolio manager” means a body corporate, which pursuant to a contract with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or goods or funds of the client, as the case may be: Provided that the Portfolio Manager may deal in goods received in delivery against physical settlement of commodity derivatives. Portfolio manager can be discretionary or non-discretionary. The discretionary portfolio manager means a portfolio manager who under a contract relating to portfolio management, exercises or may exercise, any degree of discretion as to the investment of funds or management of the portfolio of securities of the client, as the case may be. whereas the non-discretionary portfolio manager manages the funds in accordance with the directions of the client.

Co-investment Portfolio Manager” means a Portfolio Manager who is a Manager of a Category I or Category II Alternative Investment Fund(s); and:(i)provides services only to the investors of such Category I or Category II Alternative Investment Fund(s); and(ii)makes investment only in unlisted securities of investee companies where such Category I or Category II Alternative Investment Fund(s) make investments: Provided that the Co-investment Portfolio Manager may provide services to investors from any other Category I or Category II Alternative Investment Fund(s) which are managed by them and are also sponsored by the same Sponsor(s)

To act as a portfolio manager, broker must obtain certificate of registration as per the provision of SEBI (Portfolio Manager) Regulation, 2020. For considering the grant of certificate of registration to the applicant, the SEBI takes into account all matters, including given below, it deems relevant to the activities relevant to portfolio management:

- the applicant is a body corporate;
- the applicant has the necessary infrastructure like adequate office space, equipment and the manpower to effectively discharge the activities of a portfolio manager;
- the applicant has appointed a compliance officer;
- the principal officer of the applicant has– (i) a professional qualification in finance, law, accountancy or business management from a university or an institution recognized by the Central Government or any State Government or a foreign university or a professional qualification by completing a Post Graduate Program in the Securities Market (Portfolio Management) from NISM of a duration not less than one year or a professional qualification by obtaining or a CFA charter from the CFA institute; (ii) experience of at least five years in related activities in the securities market including in a portfolio manager, stock broker, investment advisor, research analyst or as a fund manager; and (iii) the relevant NISM certification as specified by the Board from time to

time. Provided that at least 2 years of relevant experience is in portfolio management or investment advisory services or in the areas related to fund management.

Provided further that a fresh NISM certification shall be obtained before expiry of the validity of the existing certification to ensure continuity in compliance with the certification requirements.

("principal officer" means an employee of the portfolio manager who has been designated as such by the portfolio manager and is responsible for: -
(i) the decisions made by the portfolio manager for the management or administration of portfolio of securities or the funds of the client, as the case may be; and
(ii) all other operations of the portfolio manager.)

- In addition to the Principal Officer and Compliance Officer, the applicant has in its employment at least one person with the following qualifications :- (i) graduation from a university or an institution recognized by the Central Government or any State Government or a foreign university; and (ii) an experience of at least two years in related activities in the securities market including in a portfolio manager, stock broker, investment advisor or as a fund manager:
- Any disciplinary action has been taken against a person directly or indirectly connected with the applicant under the Act or the rules or the regulations made there under.
- The applicant fulfils the net worth requirement (Should not be less than five crore rupees. however, portfolio managers granted registration before the commencement of SEBI (Portfolio Managers) Regulations, 2020 shall increase their net worth to not less than Rs. 5 crores within 36 months from the date of commencement of the regulations which is January 16, 2020.)
- The applicant, its director or partner, principal officer, compliance officer or the employee is involved in any litigation connected with the securities market that has an adverse bearing on the business of the applicant.
- The applicant, its director or partner, principal officer, compliance officer or the employee has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence.
- The applicant is a fit and proper person as per the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

**Fees:**

An applicant for registration as a portfolio manager is required to pay a non-refundable application fee of Rs.1,00,000 (Rupees one lakh only) to SEBI. Every portfolio manager is required to pay a sum of Rs.10 lakh as registration fees at the time of grant of certificate of

registration by SEBI. A portfolio manager who has been granted a certificate of registration, to keep its registration in force, shall pay fee of five lakh rupees every three years, from the date of grant of certificate of registration or from the date of grant of certificate of registration, within three months before expiry of the block period for which fee has been paid.[126]

**Content of Agreement between Portfolio Manager and Client:**
The portfolio manager, before taking up an assignment of management of funds or portfolio of securities on behalf of the client, enters into an agreement in writing with the client clearly defining the inter se relationship and setting out their mutual rights, liabilities and obligations relating to the management of funds or portfolio of securities containing the details as specified in Schedule IV of the SEBI (Portfolio Managers) Regulations, 2020. The portfolio manager shall provide to the client, the Disclosure Document as specified in Schedule V of the SEBI (Portfolio Managers) Regulations, 2020.

**Disclosure Document:**

The portfolio manager shall provide to the client, the Disclosure Document as specified by SEBI, prior to entering into an agreement with the client. SEBI vide its circular dated September 09, 2025[127], has provided the updated Disclosure Document in a simplified manner. The 'Disclosure Document' has been divided into two sections viz. static and dynamic.

**Code of Conduct:**
The portfolio manager shall abide by the Code of Conduct as specified in Schedule III of the SEBI (Portfolio Managers) Regulations, 2020.

**General Responsibilities of a Portfolio Manager:**
Further, portfolio managers should adhere to general obligations and responsibilities specified in the SEBI (Portfolio Managers) Regulations, 2020.

- The discretionary portfolio manager shall individually and independently manage the funds of each client in accordance with the needs of the client, in a manner which does not partake character of a Mutual Fund, whereas the non-discretionary portfolio manager shall manage the funds in accordance with the directions of the client.

[126] Registration granted prior to the commencement of the SEBI (Change in Conditions of Registration of Certain Intermediaries) (Amendment) Regulations, 2016, as the case may be.
[127]https://www.sebi.gov.in/legal/circulars/sep-2025/format-of-disclosure-document-for-portfolio-managers_96479.html

- The portfolio manager shall not accept from the clients, funds or securities worth less than Rs.50 lakh. To ensure compliance with the PM Regulations, the first single lump-sum investment amount received as funds or securities from clients should not be less than Rs.50 Lakh. Provided further that subject to appropriate disclosures in the disclosure document and the terms agreed between the client and the portfolio manager, the requirement of minimum investment amount per client shall not apply to an accredited investor. Provided further that the requirement of minimum investment amount per client shall not apply to the Co-investment Portfolio Manager.
- The portfolio manager shall act in a fiduciary capacity with regard to the client's funds and shall segregate each client's holding in securities in separate accounts.
- The portfolio manager shall keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank.
- The portfolio manager shall transact in securities within the limitation placed by the client himself with regard to dealing in securities under the provisions of the Reserve Bank of India Act, 1934 (2 of1934).
- The portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities and not borrow funds or securities on behalf of the client.
- The portfolio manager shall not borrow funds or securities on behalf of the client.
- The portfolio manager shall not lend securities held on behalf of the clients to a third person except as provided under regulation.
- The portfolio manager shall ensure proper and timely handling of complaints from his clients and take appropriate action immediately.
- The portfolio manager shall ensure that any person or entity involved in the distribution of its services is carrying out the distribution activities in compliance with the regulations and circulars issued thereunder from time to time.

**Management or administration of clients' portfolio:**

SEBI (Portfolio Managers) Regulations, 2020 specified details about "Management or administration of clients' portfolio" by portfolio manager. Some of them are given below:

- The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.
- The discretionary portfolio manager shall invest funds of his clients in the securities listed or traded on a recognized stock exchange, money market instruments, units of

Mutual Funds and other securities as specified by Board from time to time, on behalf of their clients.

- The portfolio manager offering non-discretionary or advisory services to clients may invest or provide advice for investment up to 25% of the assets under management of such clients in unlisted securities, in addition to the securities permitted for discretionary portfolio management. The portfolio manager may offer discretionary or non-discretionary or advisory services for investment up to hundred percent of the assets under management of the large value accredited investors in unlisted securities, subject to appropriate disclosures in the disclosure document and the terms agreed between the client and the portfolio manager. The Co-investment Portfolio Manager shall invest hundred percent of the assets under management in unlisted securities of investee companies where Category I and Category II Alternative Investment Funds managed by it as Manager, make investment;
- Portfolio Managers may invest in units of Mutual Funds only through direct plan.
- The portfolio manager shall not leverage the portfolio of its clients for investment in derivatives.
- The portfolio manager shall not deploy the clients' funds in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies.
- The portfolio manager shall not invest client's fund based on the advice of any other entity.
- The portfolio manager shall not while dealing with clients' funds indulge in speculative transactions i.e., it shall not enter into any transaction for purchase or sale of any security which is periodically or ultimately settled otherwise than by actual delivery or transfer of security except the transactions in derivatives.

**Other Responsibilities of a Portfolio Manager:**

The portfolio manager shall maintain separate client-wise accounts. The funds received from the clients, investments or disinvestments, all the credits to the account of the client like interest, dividend, bonus, or any other beneficial interest received on the investment and debits for expenses, if any, shall be properly accounted for and details thereof shall be properly reflected in the client's account. The portfolio manager shall furnish periodically a report to the client, as agreed in the contract, but not exceeding a period of three months and as and when required by the client. The fees on such accounts must be distinguished and accounted for separately. The books of account will be audited yearly by qualified auditor to ensure that the portfolio manager has followed proper accounting methods and procedures and that the portfolio manager has performed his duties in accordance with the law. Every portfolio manager has to appoint a custodian in respect of securities managed or

administered by it. However, if the portfolio manager provides only advisory services, then the provision does not apply. All the books of account and other records and documents shall be maintained for a period of 5 years.

**Facilitating collective oversight of distributors for Portfolio Management Services (PMS) through APMI**

Regulation 23 (11) of SEBI (Portfolio Managers) Regulations, 2020 provides that portfolio managers shall ensure that any person or entity involved in the distribution of its services is carrying out the distribution activities in compliance with the SEBI (Portfolio Managers) Regulations, 2020 and circulars issued thereunder from time to time. Additionally, portfolio managers are required to ensure that the distributors abide by the Code of Conduct as specified in Annexure 2B to the Master Circular dated March 20, 2023, for portfolio managers. In order to facilitate collective oversight of PMS distributors at the industry level, SEBI has decided that any person or entity involved in the distribution of portfolio management services shall obtain registration with Association of Portfolio Managers in India (APMI). Portfolio Managers shall ensure that any person or entity engaged in the distribution of its services has obtained registration with APMI, in accordance with the criteria laid down by APMI

**Transfer of portfolios of clients (PMS business) by Portfolio Managers**

SEBI vide its circular[128] dated October 24, 2025, provided guidelines for in the following manner:

- Transfer of PMS business from one portfolio manager to another both holding portfolio manager registration and belonging to the same group, and
- Transfer of PMS business from one portfolio manager to another portfolio manager not belonging to the same group.

## 8.5 Research Reports and Advisory Services

Under SEBI (Research Analysts) Regulations, 2014, a research entity is a registered intermediary, like a stock broker or merchant banker, that issues research reports or opinions on securities to influence investment decisions. Providing research as a "value-added service," even without a separate fee, requires mandatory SEBI registration. All associated persons must hold a valid NISM certification as specified by SEBI.

[128] https://www.sebi.gov.in/legal/circulars/oct-2025/transfer-of-portfolios-of-clients-pms-business-by-portfolio-managers-_97443.html

SEBI, has issued stringent rules and regulations pertaining to research based advisory services provided by the broking houses. Brokerage house should also comply with the relevant guidelines provided under SEBI (Research Analysts) Regulation, 2014, "Master Circular for Research Analyst" provided from time to time and Frequently Asked Questions (FAQs) related to regulatory provisions for Research Analysts.[129].

As per the SEBI Investment Advisor Regulations 2013, any stock broker registered under the SEBI (Stock Brokers) Regulations 2026, who provides any investment advice to its clients incidental to their primary activity shall not be required to seek registration under these regulations, provided that stock brokers shall comply with the general obligation(s) and responsibilities as specified therein.

Regulation 16D and 16E of the 'SEBI (Intermediaries) Regulations, 2008 ("Intermediaries Regulations"),provide for the verification of risk and return metrics by a Past Risk and Return Verification Agency (PaRRVA). Accordingly, in terms of the aforesaid regulations, claims may be made by IAs, RAs, Algo providers on-boarded by Stock Brokers and empaneled with a recognized Stock Exchange("SE"), and intermediaries permitted to provide the services of IA, RA and Algorithmic Trading ("regulated persons"), in terms of risk and return metrics verified by PaRVVA[130].

## 8.6 Depository Services

The brokers also provide depository services to investors amongst other services. To provide these services, the broker or the trading member has to get registered as a depository participant of a depository as per the SEBI Act 1992 and the Depositories Act of 1996. The relationship between the DPs and the depositories is governed by an agreement made between the two under the Depositories Act. The form of the agreement is specified in the bye-laws of the depository.

Under the Depositories Act, 1996, a DP is described as an agent of the depository. Through DP, Depositories interface with the investor and provides depository services. The SEBI (Depository & Participants) Regulations, 2018 and the bye-laws of depositories prescribe the eligibility criteria to become a DP.

On satisfying the conditions/completion of procedure of registration as laid down by the SEBI and the depositories, SEBI provides the final certificate of registration to the DP for commencement of DP related activities. Every DP shall abide by the Code of Conduct as specified in Part A of Third Schedule of SEBI (Depository Participant) Regulation, 2018 and

[129] https://www.sebi.gov.in/legal/circulars/jul-2025/frequently-asked-questions-faqs-related-to-regulatory-provisions-for-research-analysts_95549.html

[130] https://www.sebi.gov.in/legal/circulars/apr-2025/recognition-and-operationalization-of-past-risk-and-return-verification-agency-parrva-_93321.html

other guidelines specified by SEBI/Depository from time to time. The depository participant act as intermediaries between the depository and the investors. The Depository Participant can act as participant for both depositories subject to fulfillment of certain conditions. Every depository participant shall enter into an agreement with a beneficial owner/client before acting as a participant on his behalf, in a manner specified by the depository in its bye-laws. For any investor / client, to avail the services provided by the Depository, has to open Depository account, known as Demat A/c, with any of the DPs. The main activity of the DP is to open a demat account for an investor. *The main activity being the settlement and transfer of securities from one beneficiary account to another pursuant a trading activity of an investor*. A participant shall register the transfer of securities to or from a beneficial owner's account only on receipt of instructions from the beneficial owner and thereafter confirm the same to the beneficial owner. There are other services also which a DP can engage into such as:

- Opening a demat account
- Dematerialisation[131]
- Maintaining record of securities held by the beneficial owners in the electronic form
- Settlement of trades by delivery or receipt of securities from / in BO accounts
- Receiving electronic credit in respect of securities allotted by issuers under IPO or otherwise on behalf of demat account holders
- Receiving non cash corporate benefits such as allotment of bonus and rights shares or any other non-cash corporate benefits given by the issuers in electronic form on behalf of its demat account holders
- Pledging of dematerialized securities & facilitating loans against shares
- Freezing of the demat account for debits, credits, or both.

## 8.7 Margin Trading

Margin trading in the Indian equity market is a facility that allows an investor to buy more shares than they can afford with their available funds by borrowing money from their stockbroker. Brokers charge interest on such funding. This concept, also known as leverage, amplifies both potential profits and losses. SEBI has been prescribing eligibility conditions and procedural details for allowing the margin trading facility, by brokers to their clients, from time to time.

*Eligibility Requirement*

[131] Dematerialisation is the process of converting securities held in physical form into holdings in book entry form

Only corporate brokers with net worth of at least Rs.3 crore are eligible for providing margin trading facility to their clients. The stock brokers wishing to extend margin trading facility to their clients shall be required to obtain prior permission from the exchange where the margin trading facility is proposed to be offered.

*Securities eligible for margin trading*

The facility of margin trading is available for those securities which are classified as Group 1 securities according to the SEBI circular no. SEBI/HO/MRD/DP/CIR/P/2016/135 dated December 16, 2016 and Equity Exchange Traded Funds (ETF) categorised as group according to SEBI circular dated November 30, 2022. In order to avail margin trading facility, initial margin required shall be as under:

| Category of Stocks | Applicable margin |
|---|---|
| Group 1 stocks available for trading in the F&O segment | VaR + 3 times of applicable Extreme Loss Margin |
| Group 1 stocks other than F&O stocks & Units of Equity ETF | VaR + 5 time of applicable Extreme Loss Margin |

For aforesaid purpose the applicable VaR and ELM shall be as in the cash segment for a particular stock & units of equity ETF.

The initial margin payable by the client to the Stock Broker shall be in the form of cash, cash equivalent or Group I equity shares & units of equity ETF, with appropriate haircut.

Stock brokers shall ensure maintenance of the aforesaid margin at all times during the period that the margin trading facility is being availed by the client. In case of short fall, stock broker shall make necessary margin calls.

The Stock brokers shall be required to comply with the following conditions:

i. The stocks or units of Equity ETFs deposited as collateral with the stock broker for availing margin trading facility (Collaterals) and the stocks or units of Equity ETFs purchased under the margin trading facility ('Funded stocks') shall be identifiable separately and no comingling shall be permitted for the purpose of computing funding amount. Further, if the broker has collected cash collateral from the client in form of margin for availing margin trading facility and the Trading Member has given the said cash collateral to the Clearing Corporation (CC) towards settlement obligation of the said client, then same can be considered as maintenance margin to the extent of securities received from CC against such cash collateral given to CC and such shares are pledged in favour of Trading Member in form of funded stock.

ii. Collateral and Funded stocks shall be marked to market on a daily basis.

iii. In case of increase in the value of Collaterals, stock brokers may have the option of granting further exposure to their clients subject to applicable haircuts. For the purpose of applicable haircuts for units of Equity ETFs as collateral for MTF, it is clarified that the haircuts applicable to Liquid (Group I) Equity Shares (under "Other Liquid Assets" category)

as per SEBI circular MRD/DoP/SE/Cir-07/2005 dated February 23, 2005 shall be applicable to units of Equity ETFs.

iv. However, no such exposure shall be permitted on the increased value of Funded stocks.

v. In case the funded stock is considered towards maintenance margin to the extent of cash collateral provided by the client, The Trading Member shall ensure that the funded stock considered is under Group 1 securities. The applicable margin shall be VaR + 5 times of Extreme Loss Margin, irrespective of whether the funded stock is available in F&O segment or not.

Stock brokers shall ensure maintenance of the aforesaid margin at all times during the period that the margin trading facility is being availed by the client. In case of short fall, stock broker shall make necessary margin calls.

Example 1: Client A has bought 1 Quantity of Group 1 F&O Stock at Rs. 100 and Margin has been collected in form of Cash. Var & ELM on said scrip is 12.5% and 5% respectively. Initial Margin requirement for availing MTF in said scrip would be as under:
Var + 3 times of ELM i.e. 12.5+15=27.5% of Rs. 100.
After availing MTF in said scrip, if the initial margin given in the form of cash as mentioned above i.e. Rs. 27.5 has been used for pay-in i.e. settlement obligation of said client on settlement day and funded stock received from CC to the extent of such cash used for pay-in is being maintained for margin purpose (i.e. maintenance margin) then funded value i.e. exposure would be 72.5 and rate of margin requirement on said funded stock would be as under assuming there is no change in Var & ELM rate and market price of said scrip:
Var + 5 times of ELM i.e. 12.5+25=37.5% on the cost of funded stock or market value of the funded stock whichever is lower i.e. Rs. 72.5 i.e. (funded value after reducing cash collateral used for pay-in).
Example 2: In the above Example 1, if after availing MTF in said scrip, if the initial margin given in the form of cash as mentioned above is not used for pay in and is being maintained with member for margin purpose (i.e. maintenance margin) and upstreamed to CC and allocated to respective client then funded value i.e. exposure would be Rs. 100 and rate of margin requirement on said funded stock would remain same i.e. Var + 3 times of ELM i.e. 12.5+15=27.5% on Rs. 100.

Members should ensure that the initial margin for availing MTF facility is collected as per the aforementioned prescribed rate on the purchase value of funded shares. The maintenance margin is maintained for all the open funded positions as per the aforementioned prescribed rate at all times on the cost of funded stock or market value of the funded stock whichever is lower. Further, Members shall also ensure to collect Mark to Market margin (MTM) (in form of cash or non-cash collateral) in cases where the market value of the funded stock is less than the funded cost of the stock.

Example: Client bought 1 Quantity of Group 1 F&O Scrip A at Rs. 100 and the Closing Price of Scrip is 100 on T day. On T+1, Closing Price is 90. Margin is collected in non-cash form i.e. securities without cash collateral.
Initial, Maintenance Margin & MTM Requirement on T day would be as under:
Initial Margin:- VaR + 3 Times ELM on Rs. 100
MTM:- Nil (Funded Value basis purchase value i.e. 100 minus Closing Value basis closing rate i.e. 100)
Maintenance Margin: Not applicable as initial margin to be collected and maintained

Initial, Maintenance Margin & MTM Requirement on T+1 day would be as under:
Initial Margin :- Not applicable as maintenance margin to be maintained
MTM:- 10 (Funded Value basis purchase value i.e. 100 minus Closing Value basis closing rate i.e. 90)
Maintenance Margin: VaR + 3 Times ELM on Rs. 90.

*Liquidation of Securities by the Stock Broker in case of default by the client*

The stock broker shall list out situations/conditions in which the securities may be liquidated and such situations/conditions shall be included in the "Rights and Obligations Document" but not exceeding 5 working days from the day of margin call. The broker shall liquidate the securities, if the client fails to meet the margin call to comply with the conditions as mentioned in this circular or specified in the "Rights and Obligations Document" specified by exchange. However, the broker shall not liquidate or use in any manner the securities of the client in any situation other than the conditions stated above.

*Sources of Funds*

For the purpose of providing the margin trading facility, a stock broker may use own funds or borrow funds from scheduled commercial banks and/or NBFCs regulated by RBI. Stock brokers may borrow funds by way of issuance of Commercial Paper (CP) and by way of unsecured long term loans from their promoters and directors. The borrowing by way of issuance of CPs shall be subject to compliance with appropriate RBI Guidelines. The borrowing by way of unsecured long term loans from the promoters and directors shall be subject to the appropriate provisions of Companies Act 2013. A stock broker shall not be permitted to borrow funds from any other source, except the sources stated in the SEBI circular. The stock broker shall not use the funds of any client for providing the margin trading facility to another client, even if the same is authorized by the first client.

*Leverage and Exposure Limits*

At any point of time, the total indebtedness of a broker for the purpose of margin trading shall not exceed 5 times of his net worth. If the net-worth of Member X is Rs. 3 Crores, then the total indebtedness for the purpose of MTF shall not exceed Rs. 15 crores. The maximum allowable exposure of the broker towards the margin trading facility shall be within the self-imposed prudential limits and shall not, in any case, exceed the borrowed funds and 50% of his "net worth". If the net worth of Member X is Rs. 3 Crores and total of borrowings is Rs.1 crore then the total of exposure that is permitted to be provided shall not exceed Rs.2.5crores ( 1 +50% of 3 = 2.5). Exposure = Outstanding funded amount – cash collateral used for pay-in.

While providing the margin trading facility, the broker shall ensure that:

a) Exposure to any single client at any point of time shall not exceed 10% of the broker's maximum allowable exposure.

| **Particulars** | | **Amount** | **Amount** |
|---|---|---|---|
| Member's net worth | A | Rs. 5 Crs | Rs. 5 Crs |
| Total amount of borrowing for MTF | B | Rs. 20 Crs | Nil |
| Maximum allowable exposure | C= 50% of A + B | Rs. 22.50 Crs | Rs. 2.50 Crs |
| Actual exposure provided | D | Rs. 10 Crs | Rs. 2 Crs |
| Max exposure to any single client | E = 10% of C | Rs. 2.25 Crs | Rs. 0.25 Crs |

b) Exposure towards stocks & units of equity ETF purchased under margin trading facility and collateral kept in the form of stocks & units of equity ETF are well diversified. Stock brokers shall have appropriate Board approved policy in this regard.

*Rights and Obligations for Margin Trading*

The stock exchanges shall frame a Rights and Obligations document laying down the rights and obligations of stock brokers and clients for the purpose of margin trading facility. The Rights and Obligations document shall be mandatory and binding on the Broker/Trading Member and the clients for executing trade in the Margin Trading framework.

The broker/exchange may modify the Rights and Obligations document only for stipulating any additional or more stringent conditions, provided that no such modification shall have the effect of diluting any of the conditions laid down in the circular or in the Rights and Obligations document.

*Maintenance of Records*

- The stock broker shall maintain separate client-wise ledgers for funds and securities of clients availing margin trading facility.
- The stock broker shall maintain a separate record of details of the funds used and sources of funds for the purpose of margin trading.
- The books of accounts, maintained by the broker, with respect to the margin trading facility offered by it, shall be audited on a half yearly basis. The stock broker shall submit an auditor's certificate to the exchange, within one month from the date of the half year ending 31st March and 30th September of a year certifying, inter alia, the extent of compliance with the conditions of margin trading facility. The certificate shall be in addition to the certificate on net worth.

*Disclosure Requirements*

The stock broker shall disclose to the Stock Exchanges details on gross exposure towards margin trading facility including name of the client, Category of holding (Promoter/promoter group or Non-promoter), clients' Permanent Account Number ("PAN"), name of the scrips (Collateral stocks and Funded stocks) and if the stock broker has borrowed funds for the purpose of providing margin trading facility, name of the lender and amount borrowed, on or before 6 pm on T+1 day.

The Stock Exchanges shall disclose on their websites the scrip wise and Equity ETF gross outstanding in margin accounts with all brokers to the market. Such disclosure regarding margin trading done on any day shall be made available after the trading hours, on the following day, through its website.

*Other Conditions*

- A broker shall take adequate care and exercise due diligence before providing margin trading facility to any client.
- Any disputes arising between the client and the stock broker in connection with the margin trading facility shall have the same treatment as normal trades and should be covered under the investor grievance redressal mechanism, arbitration mechanism of the Stock Exchange.
- SGF and IPF shall be available for transactions done on the exchange, whether through normal or margin trading facility. However, any losses suffered in connection with the margin trading facility availed by the client from the stock broker shall not be covered under IPF.
- The stock brokers wishing to extend margin trading facility to their clients shall be required to obtain prior permission from the exchange where the margin trading facility

is proposed to be offered. The exchange shall have right to withdraw this permission at a later date, after giving reasons for the same.

Funded stocks held by the TM / CM under the margin trading facility shall be held by the TM / CM only by way of pledge. For this purpose, the TM / CM shall be required to open a separate demat account tagged 'Client Securities under Margin Funding Account' in which only funded stocks in respect of margin funding shall be kept/ transferred, and no other transactions shall be permitted. Such funded stocks shall be transferred to respective client's demat account followed by creation of an auto-pledge (i.e., without the requirement of a specific instruction from the client) with suitable reason, in favor of 'Client Securities under Margin Funding Account'.

## 8.8 Internet Based Trading (IBT) & Securities Trading Using Wireless Technology (STWT)

Internet Based trading can take place through order routing systems, which will route client orders, to exchange trading systems, for execution of trades on the existing stock exchanges. SEBI Registered Brokers can introduce this service after obtaining permission from respective Stock Exchanges. The stock exchange should grant approval or reject the application as the case may be and communicate its decision to the member within 7 calendar days of the date of completed application submitted to the exchange. Exchanges while giving permission will be required to ensure minimum conditions specified by SEBI from time to time. SEBI registered brokers who provide Internet Based Trading shall be eligible to provide securities trading using wireless technology. All relevant requirements applicable to internet based trading shall also be applicable to securities trading using wireless technology. Securities Trading using Wireless technology shall include devices such as mobile phone, laptop with data card, etc., that use Internet Protocol (IP).

The stock exchange, before giving permission to brokers to start Internet based services shall ensure the fulfilment of the minimum conditions as specified by SEBI from time to time. Some of them are given below:

- Net worth Requirement: The broker must have a minimum net worth of Rs.50 lacs if the broker is providing the Internet based facility on his own. However, if some brokers collectively approach a service provider for providing the internet based trading facility, net worth criteria as stipulated by the stock exchange will apply.
- Operational and System Requirements: The Stock Exchange must ensure that the system used by the broker has provision for security, reliability and confidentiality of data through use of encryption technology. The Stock Exchange must ensure that the brokers maintain adequate backup systems and data storage capacity. The Stock Exchange must also ensure that the brokers have adequate system capacity for handling

data transfer and arranged for alternative means of communications in case of Internet link failure. The Stock Exchange must lay down the minimum qualification for personnel to ensure that the broker has suitably qualified and adequate personnel to handle communication including trading instructions as well as other back office work which is likely to increase because of higher volumes.

- Client Broker Relationship: Additional rights & obligations provided to client in case of internet / wireless technology-based trading. The broker web site providing the internet based trading facility should contain information meant for investor protection such as rules and regulations affecting client broker relationship, arbitration rules, investor protection rules etc. The broker web site providing the Internet based trading facility should also provide and display prominently, hyper link to the web site/ page on the web site of the relevant stock exchange(s) displaying rules/ regulations/circulars. Ticker/quote/order book displayed on the website of the broker should display the time stamp as well as the source of such information against the given information. Order/Trade confirmation should also be sent to the investor through email at client's discretion at the time period specified by the client in addition to the other mode of display of such confirmations on real time basis on the broker web site.
- Risk Management: Exchanges must ensure that brokers have a system-based control on the trading limits of clients, and exposures taken by clients. Brokers must set pre-defined limits on the exposure and turnover of each client. The broker systems should be capable of assessing the risk of the client as soon as the order comes in. Reports on margin requirements, payment and delivery obligations, etc. should be informed to the client through the system.
- Cross Trades: As in the case of existing system, brokers using Internet based systems for routing client orders will not be allowed to cross trades of their clients with each other. All orders must be offered to the market for matching.
- Standards for Web Interfaces and Protocols: Between a Trading Web Server and Trading Client Terminals, Interfaces Standards as per recommendations of IETF (Internet Engineering Task Force) and W3C (World Wide Web Consortium) may be adopted. E.g.: HTTP Ver 4 or above HTML Ver 4/XML.
- System Operations: Brokers should follow the similar logic/priorities used by the Exchange to treat client orders. Brokers should maintain all activities/ alerts log with audit trail facility. Broker Web Server should have internally generated unique numbering for all client order/trades.
- Network Security: The following security features are mandatory for all Internet based trading systems:

    a) User Id
    b) First Level password

c) Automatic expiry of passwords at the end of a reasonable duration. Re-initialize access on entering fresh passwords
d) All transaction logs with proper audit facilities to be maintained in the system.
e) Secured Socket Level Security for server access through Internet
f) Suitable Firewalls between trading set-up directly connected to an Exchange trading system and the Internet trading set-up.

The stock exchange shall ensure that the broker complies with the following:

- There shall be secure access, encryption and security of communication for internet-based trading and securities trading using wireless technology. DOT policy and regulation shall govern the level of encryption.
- Adequate measures should be taken for user identification, authentication and access control using means such as user-id, passwords, smart cards, biometric devices or other reliable means, to prevent misuse of facility by unauthorized persons.
- Unique identification number as given in case of internet-based trading shall be made applicable for securities trading using wireless technology.
- In case of failure of the wireless network, alternative means of communication for placing orders should be available.
- Additional provisions specifying possible risks, responsibilities and liabilities associated with securities trading using wireless technology should be incorporated in the Broker-Client agreement as an addendum or by bringing to the notice of clients, who are desirous of availing such facility, and taking their concurrence on the same.
- As it may not be possible to give detailed information to the investor on a hand-held device e.g. mobile phones, it may be ensured that minimum information may be given with addresses of the Internet web site/web page where detailed information would be available.
- Order confirmation should be provided to the user on submitting the order. Order modification / cancellation facilities should also be provided. Trade confirmation should be provided to the user, along with history of trades for the day.
- Session login details should not be stored on the devices used for internet-based trading and securities trading using wireless technology.
- Network security protocols and interface standards should be as per prevalent industry standards and sound audit trails should be available for all transactions conducted using wireless devices.
- The broker's server routing orders to the exchange trading system shall be located in India.
- Stock exchanges shall arrange for periodic systems audits of broker systems to ensure that requirements specified in the circulars are being met.
- Stock exchange shall also include securities trading using wireless technology in their ongoing investor awareness and educational programme

Additional Requirements for Internet Based Trading (IBT) and Securities trading using Wireless Technology (STWT)

- The broker shall capture the IP (Internet Protocol) address (from where the orders are originating)
- The brokers system should have built-in high system availability to address any single point failure.
- There should be secure end-to-end encryption for all data transmission between the client and the broker through a Secure Standardized Protocol.
- A procedure of mutual authentication between the client and the broker server should be implemented.
- The broker system should have adequate safety features to ensure it is not susceptible to internal/external attacks.
- In case of failure of IBT/ STWT, the alternate channel of communication shall have adequate capabilities for client identification and authentication.
- In case of no activity by the client, the system should provide for automatic trading session logout
- Two-factor authentication for login session may be implemented for all orders emanating using Internet Protocol. Public Key Infrastructure (PKI) based implementation using digital signatures, supported by one of the agencies certified by the government of India, is advisable. Further the two factors in the Two-factor authentication framework should not be same.
- Further to the above, the following practice is advisable: The back-up and restore systems implemented by the broker should be adequate to deliver sustained performance and high availability. The broker system should have on-site as well as remote site back-up capabilities.

Testing of software used in or related to Trading and Risk Management: With an objective to support the product development activities, Test market facility including Simulated Environment is provided by the exchange to the members for testing their software. The term 'software' shall mean electronic systems or applications used by stock brokers / trading members for connecting to the stock exchanges and for the purposes of trading and real-time risk management, including software used for Internet Based Trading (IBT), Direct Market Access (DMA), Securities Trading using Wireless Technology (STWT), Smart Order Routing (SOR), Algorithmic Trading (AT) etc. The stock broker / trading member shall undertake UAT of the software to satisfy itself that the newly developed / modified software meets its requirements. Stock brokers / trading members shall engage system auditor(s) to examine reports of mock tests and UAT in order to certify that the tests were satisfactorily undertaken.

As part of compliance, stock brokers would be required to submit the System Audit Report on periodic basis to the Exchange after getting the facility audited from CISA /CISSP / ISA / DISA certified auditor as specified by the Exchange from time to time.

Stock Broker can also provide facility like Direct Market Access, facility for algorithmic trading, Smart Order Routing etc. to clients as specified by SEBI/Exchanges from time to time.

**Chapter 8 : Sample Questions**

1. _____ is a process by which a company offers shares for sale to public for the first time.

   (a) FPO

   **(b) IPO**

   (c) Private Placement

   (d) QIP

2. ASBA is the acronym for_____.

   **(a) Application Supported by Blocked Amount**

   (b) Applying Sponsoring Brokers Amounts

   (c) Application Supports for Brokers Amount

3. Only corporate brokers with net worth of at least _____ are eligible for providing margin trading facility.

   **(a) Rs. 3 crores**

   (b) Rs. 1 crores

   (c) Rs. 5 crore

   (d) Rs. 50 lakh

4. The portfolio manager must have a minimum net worth of Rs. _____ .

   **(a) Rs. 5 Crore**

   (b) Rs. 1 crore

   (c) Rs. 3 Crore

5. If the net-worth of Member X is Rs.10 Crores, then the total indebtedness for the purpose of Margin Trading Facility shall not exceed Rs. _____ crores.

   (a) **Rs. 50 Crore**

   (b) Rs. 100 crore

   (c) Rs. 300 Crore

## Annexure 1: Code of Conduct for Stock Brokers

**General:**

A Stock Broker shall:

1. Maintain high standards of integrity, promptitude and fairness in the conduct of all his business.
2. Act with due skill, care and diligence in the conduct of all his business.
3. Not indulge in manipulative, fraudulent or deceptive transactions or schemes or spread rumours with a view to distorting market equilibrium or making personal gains.
4. Not create false market either singly or in concert with others or indulge in any act detrimental to the investors' interest or which leads to interference with the fair and smooth functioning of the market.
5. Not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness.
6. Abide by all the provisions of the Act and the rules, regulations issued by the Government, SEBI and the Stock Exchange from time to time as may be applicable to him.

**Duty towards the Investor**

1. A stock-broker, in his dealings with the clients and the general investing public, shall faithfully execute the orders for buying and selling of securities at the best available market price and not refuse to deal with a Small Investor merely on the ground of the volume of business involved.
2. A stock-broker shall promptly inform his client about the execution or non-execution of an order and make prompt payment in respect of securities sold and arrange for prompt delivery of securities purchased by clients.
3. A stock-broker shall issue without delay to his client a contract note for all transactions in the form specified by the stock exchange.

4. A stock-broker shall not disclose or discuss with any other person or make improper use of the details of personal investments and other information of a confidential nature of the client which he comes to know in his business relationship.

5. A stock-broker shall not encourage sales or purchases of securities with the sole object of generating brokerage or commission. He shall not furnish false or misleading quotations or give any other false or misleading advice or information to the clients with a view of inducing him to do business in particular securities and enabling himself to earn brokerage or commission thereby.

6. A stock-broker shall not deal or transact business knowingly, directly or indirectly or execute an order for a client who has failed to carry out his commitments in relation to securities with another stock-broker.

7. A stock-broker, when dealing with a client, shall disclose whether he is acting as a principal or as an agent and shall ensure at the same time that no conflict of interest arises between him and the client. In the event of a conflict of interest, he shall inform the client accordingly and shall not seek to gain a direct or indirect personal advantage from the situation and shall not consider clients' interest inferior to his own.

8. A stock-broker shall not make a recommendation to any client who might be expected to rely thereon to acquire, dispose of, retain any securities unless he has reasonable grounds for believing that the recommendation is suitable for such a client upon the basis of the facts, if disclosed by such a client as to his own security holdings, financial situation and objectives of such investment.

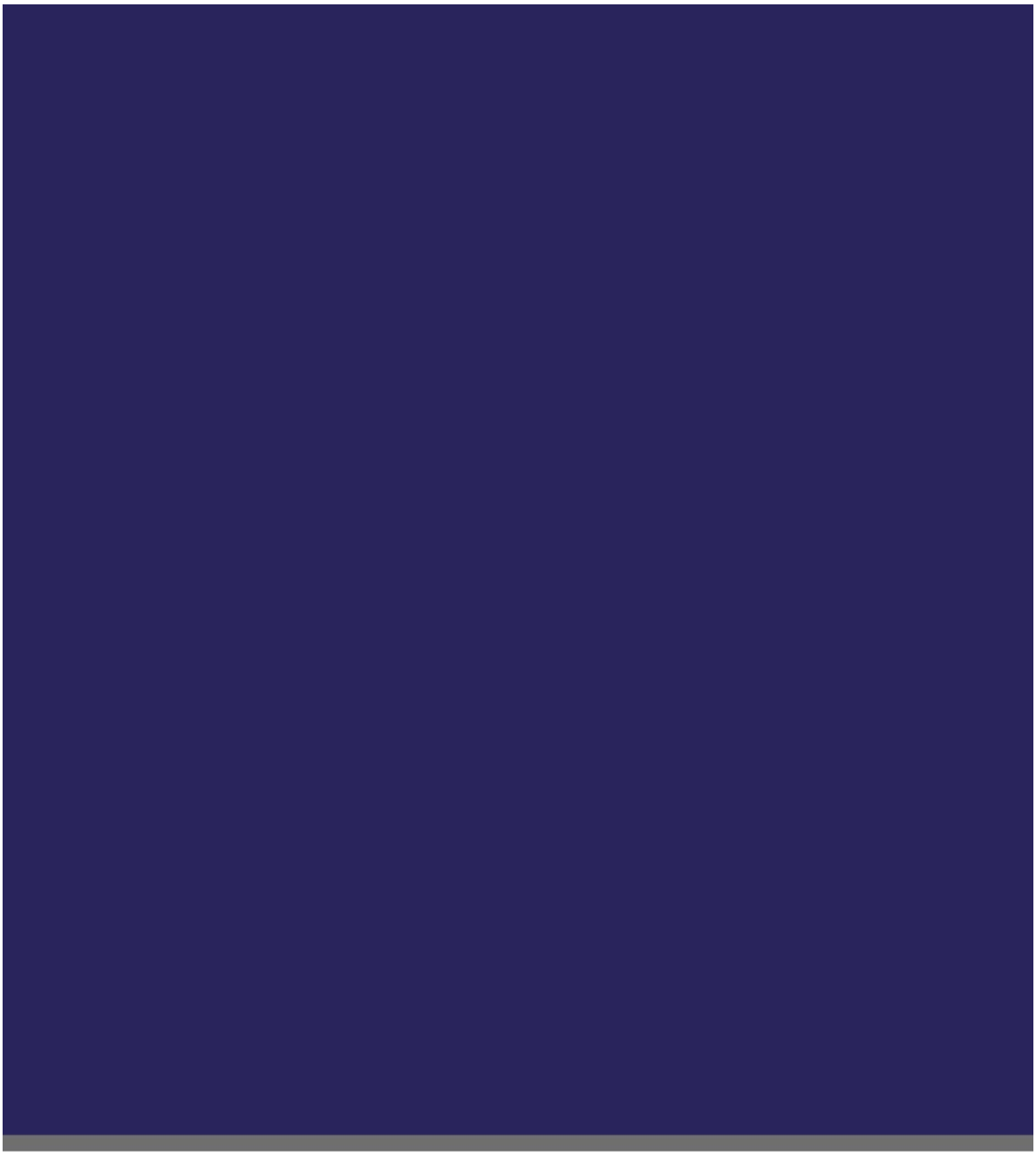
9. A stock broker or any of his employees shall not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of his interest including the interest of his dependent family members and the employer including their long or short position in the said security has been made, while rendering such advice.

   In case an employee of the stock broker is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

10. A stock-broker should have adequately trained staff and arrangements to render fair, prompt and competence services to his clients.

**Duty towards Other Stock-Brokers**

1. A stock-broker shall co-operate with the other contracting party in comparing unmatched transactions. A stock-broker shall not knowingly and wilfully deliver documents which constitute bad delivery and shall co-operate with other contracting party for prompt replacement of documents which are declared as bad delivery.
2. A stock-broker shall extend fullest co-operation to other stock-brokers in protecting the interests of his clients regarding their rights to dividends, bonus shares, right shares and any other right related to such securities.
3. A stock-broker shall carry out his transactions with other stock-brokers and shall comply with his obligations in completing the settlement of transactions with them.
4. A stock-broker shall not advertise his business publicly unless permitted by the stock exchange.
5. A stock-broker shall not resort to unfair means of inducing clients from other stock-brokers.
6. A stock-broker shall not neglect or fail or refuse to submit the required returns and not make any false or misleading statement on any returns required to be submitted to the SEBI and the stock exchange.




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