



**भारतीय प्रतिभूति और विनिमय बोर्ड**  
**Securities and Exchange Board of India**

**MASTER CIRCULAR**

CDMRD/DMP/CIR/P/2018/126

**September 07, 2018**

To,

**All Stock Exchanges and Clearing Corporation with Commodity Derivatives Trading**

Dear Sir / Madam,

**Sub: Master Circular for Commodity Derivatives Market**

1. Securities and Exchange Board of India (SEBI) has been issuing various circulars/directions from time to time for commodity derivatives market.
2. This Master Circular is a compilation of the circulars issued by Commodity Derivatives Market Regulation Department (CDMRD) pertaining to domestic commodity derivatives segment, which are issued till the date of this circular.
3. In case of any inconsistency between the Master Circular and the original applicable circular, the content of the original circular shall prevail.
4. This circular is available on SEBI Website at [www.sebi.gov.in](http://www.sebi.gov.in) .

Yours faithfully,

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## **Chapter 1. Governance and Administration of Exchanges and Clearing Corporations**

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### **1.1. Timelines for Compliance with various provisions of Securities Laws by Commodity Derivatives Exchanges<sup>1</sup>**

- 1.1.1. Commodity derivatives exchanges shall comply with the provisions of SCRA, applicable provisions of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012, ('SECC Regulations') and SEBI circular CIR/MRD/DSA/33/2012 dated December 13, 2012, on procedural norms on recognition, ownership and Governance for Stock Exchanges and Clearing Corporation ('SECC Circular').
- 1.1.2. The timelines prescribed herein, for compliance with various provisions of Securities Laws shall be reckoned from September 28, 2015.
- 1.1.3. **Clearing and Settlement:** Commodity derivatives exchanges shall transfer the functions of clearing and settlement of trade to a separate clearing corporation within three years. Till then, the exchanges may continue with the existing arrangement for clearing and settlement of trades.
- 1.1.4. **Validity of recognition of Commodity Derivative Exchanges:** Validity of recognition of commodity derivatives exchanges under SCRA shall be taken to be the same as the validity of their recognition under FCRA. Further, the renewal of recognition, if any, will be as per SCRA and SECC Regulations.

The conditions required to be continuously complied with by recognized stock exchanges as given in Regulation 7(3) of SECC Regulations shall be complied with by national commodity derivative exchanges.

However, commodity derivatives exchanges shall immediately put in place adequate surveillance system to monitor positions, prices and volumes etc. so as to ensure market integrity till online real-time surveillance systems are set up and operationalized.

Conditions required to be continuously complied with by recognized clearing corporations given in Regulation 7(4) of SECC Regulations, to the extent applicable, shall be complied with by national commodity derivatives exchanges.

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<sup>1</sup> SEBI Circular No [CIR/CDMRD/DEA/03/2015](#), dated November 26, 2015

1.1.5. **Regulatory Fee:** Commodity derivatives exchanges shall pay the regulatory fee in terms of Securities and Exchange Board of India (Regulatory Fee on Stock Exchanges) Regulations, 2006.

1.1.6. **Networth Requirements:** Commodity derivatives exchanges shall comply with Regulation 14(1) of SECC Regulations as specified below:

- I. Commodity derivative exchanges shall not distribute profits in any manner to its shareholders until the requisite net worth of INR 100 crores is achieved in terms of Regulation 14(4) of SECC Regulations.
- II. Commodity derivatives exchanges shall submit audited net worth certificate from the statutory auditor on an yearly basis by the thirtieth day of September every year for the preceding financial year in terms of Regulation 14(5) of SECC Regulations.

1.1.7. **Ownership**

- I. National commodity derivatives exchanges shall comply with the shareholdings limits specified under SECC Regulations, 2012 by May 5, 2019. As per clause 5 of SECC Circular, they shall put in place a monitoring mechanism to ensure compliance with the shareholding restrictions specified in SECC Regulations.
- II. Regulations 20 to 22 of SECC Regulations shall be applicable to national commodity derivative exchange. The format for submitting shareholding pattern to SEBI is given in **Annexure A**.

1.1.8. **Governance**

- I. Provisions of Regulations 23 to 26 shall be applicable to national commodity derivatives exchanges, subject to the following:
  - A. Existing Independent Directors on the boards of national commodity derivatives exchanges shall be deemed to be Public Interest Directors (PIDs) under SECC Regulations,



- B. All new appointments on the governing boards of national commodity derivatives exchanges shall be governed by the provisions of SECC Regulations and SECC Circular.
- II. National Commodity Derivatives Exchanges shall comply with the provisions of Regulation 27 of SECC Regulations
- 1.1.9. **Segregation of Regulatory Departments:** Commodity derivatives exchanges shall segregate their regulatory departments (as indicated in SECC Circular) from other departments in the **manner** specified in Part C of Schedule II of SECC Regulations.
- 1.1.10. **Oversight Committees:** Commodity derivative exchanges shall comply with the requirements of Regulation 29 read with Regulation 44D (1) (b) of SECC Regulations. National **commodity** derivatives exchanges shall constitute an oversight committee for 'Product design', chaired by a Public Interest Director.
- 1.1.11. **Advisory Committee and other Statutory Committees:** National commodity derivatives exchanges shall constitute Advisory committees in line with Regulation 30 of SECC Regulations, 2012 and statutory committees as specified in SECC Circular.
- 1.1.12. **Risk Management Committee:** Till the functions of clearing and settlement are transferred to a separate clearing corporation, commodity derivatives exchanges shall comply with provisions of Regulation 31 of SECC Regulations relating to risk management committee. This committee shall be constituted.
- 1.1.13. **Appointment of Compliance Officer:** All commodity derivative exchanges shall appoint a compliance officer in terms of Regulation 32 of SECC Regulations.
- 1.1.14. **Transfer of Penalties:** National commodity derivative exchanges shall credit all settlement related penalties to their settlement guarantee fund (SGF) and other penalties to Investor Protection Fund (IPF).
- 1.1.15. **Disclosure and Corporate Governance Norms:** Regulation 35 of SECC Regulations shall be applicable to national commodity derivative exchanges.
- 1.1.16. **General Obligations**
- I. Till the functions of clearing and settlement are transferred to a separate clearing corporation, commodity derivative



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exchanges shall comply with the provisions of Regulation 39 of SECC Regulations on Fund to guarantee settlement of trades.

- II. The provisions of Regulations 41, 42, 43, 44 and 44A of SECC Regulations to a recognized stock exchange shall be applicable to commodity derivatives exchanges. Additionally, the provisions of Regulations 41, 42, 43, 44 and 44A of SECC Regulations in so far as they pertain to a recognized clearing corporation shall be applicable to commodity derivatives exchanges till the functions of clearing and settlement are transferred to a separate clearing corporation
  - III. Till the functions of clearing and settlement are transferred to a separate clearing corporation, commodity derivative exchanges shall have right to recover dues from its trading/clearing members arising from the discharge of their clearing and settlement functions from the collaterals, deposits and the assets of the trading/clearing members in line with Regulation 44B of SECC Regulations.
  - IV. Regulation 44C and 44D of SECC Regulations shall be applicable to commodity derivatives exchanges.
- 1.1.17. **Listing:** Regulation 45 of SECC Regulations shall be applicable to commodity derivatives exchanges.
- 1.1.18. **Dematerialization of Securities:** National commodity derivative exchanges shall comply with Regulation 46 of SECC Regulations with respect to holding securities in dematerialized form.

### 1.2. Monthly Development Report for Commodity Derivative Exchanges<sup>2</sup>

- 1.2.1. The Commodity Derivative Exchanges are advised to submit a Monthly Development Report as per the prescribed format to SEBI by 7<sup>th</sup> of the succeeding month.
- 1.2.2. The format for the Monthly Report is provided at **Annexure B**.

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<sup>2</sup> SEBI Circular No [CIR/CDMRD/DEA/4/2015](#), dated December 9, 2015

### **1.3. Mandatory requirements / exit policy for Commodity Derivatives Exchanges<sup>3</sup>**

- 1.3.1. If there is no trading operation on the platform of any commodity derivatives exchanges for more than twelve months then such exchange shall be liable to exit.
- 1.3.2. In addition to the above, henceforth, all National Commodity Derivative Exchanges shall continuously meet the turnover criteria of Rs. 1000 crores per annum. The Regional Commodity Exchanges shall ensure that they have at least 5% of the nation-wide market share of the commodity, which is principally traded on their platform. In case the National and Regional Commodity Exchanges fail to meet the above criteria for 2 consecutive years, they shall be liable to exit.
- 1.3.3. In the event a recognized commodity derivatives exchange, for any reason suspends its trading operations, it shall resume its trading only after ensuring that adequate and effective trading systems, clearing and settlement systems, monitoring and surveillance mechanisms, risk management systems are put in place and only after complying with all other regulatory requirements stipulated by SEBI from time to time. Further, such recognized commodity derivatives exchanges shall resume trading operations only after obtaining prior approval from SEBI.
- 1.3.4. In case any commodity derivatives exchange proposes to surrender its recognition voluntarily or whose recognition is proposed to be withdrawn by SEBI, the concerned Exchange shall be directed to comply with the following:
  - I. The concerned commodity derivatives exchange shall not alienate any assets of the exchange without taking prior approval of SEBI.
  - II. Treatment of the assets of de-recognized exchange:
    - A. The concerned commodity derivatives exchange shall be permitted to distribute its assets subject to certain conditions as laid down in this circular as well as other guidelines that may be issued by SEBI, Government, or any other statutory authority, from time to time.

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<sup>3</sup> SEBI Circular No. [CIR/CDMRD/DEA/01/2016](#), dated January 11, 2016



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- B. For the purpose of valuation of the assets of the commodity derivative exchange, a valuation agency shall be appointed by SEBI. All the valuation charges shall be paid by the concerned exchange.
- C. The quantum of assets for distribution will be available after payment of statutory dues including income tax, transfer of funds as specified in [para III below](#), payment of dues as specified in [para IV below](#), refund of deposit (refundable) to the stock brokers / clearing members including their initial contribution / deposit to Settlement Guarantee Fund/ Trade Guarantee Fund (SGF/TGF) and contribution to SEBI as specified in [para V \(D\) below](#).
- III. The concerned exchange shall transfer the Investor Protection Fund or any such fund to the SEBI Investor Protection and Education Fund.
- IV. The concerned exchange shall pay following dues to SEBI:
  - A. The dues outstanding to SEBI and the annual regulatory fee.
  - B. The outstanding registration fees of brokers/trading members of such de-recognised stock exchanges as specified in the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of such de-recognition.
  - C. Dues of the brokers to SEBI shall be recovered by the exchange out of the brokers' deposits / capital / share of sale proceeds / winding up proceeds dividend payable, etc. available with the exchange.
  - D. The exchange will be liable to make good any shortfall in collection of dues of the brokers to SEBI.
- V. Other Conditions
  - A. In case any commodity derivatives exchange, after de-recognition, continues as corporate entity under the Companies Act, 2013, it shall not use the expression 'stock exchange', 'commodity derivative exchange' or 'exchange' or any variant in its name or in its subsidiaries name so as to avoid any representation of present or past affiliation with the exchange.



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- B. The Sale / distribution / transfer of assets / winding up of such exchanges / companies shall be subject to the applicable laws in force.
  - C. The concerned commodity derivatives exchange shall set aside sufficient funds in order to provide for settlement of any claims, pertaining to pending arbitration cases, arbitration awards, not implemented, if any, liabilities/claims of contingent nature, if any, and unresolved investors complaints/ grievances lying with the exchange.
  - D. In case of de-recognition and exit, the stock exchange shall contribute up to 20% of its assets (after tax) towards SEBI Investor Protection and Education Fund (IPEF) for investor protection and in order to cover future liabilities, if any. The contribution may be decided by SEBI taking into account, inter alia, the governance standards of the commodity derivatives exchange and estimation of future liabilities.
- VI. SEBI may impose additional conditions as deemed fit in the interest of trade or in the public interest including securities market.



## Chapter 2. Trading

### 2.1. Trading Hours/Trading Holidays on Commodity Derivatives Exchanges<sup>4</sup>

#### 2.1.1. Trading Hours

- I. All Commodity Derivatives Exchanges shall permit trading only from Monday to Friday.
- II. Trading hours shall be fixed by the Exchange within the time limits as mentioned in the table below:

S. No	Commodity Category	Trade Start Time	Trade End time	
			After Start of US Day light Savings in Spring Season	After End of US Day light Savings in Fall Season
1	Internationally Referenceable Non-Agri Commodities	10:00 AM	11:30 PM	11:55 PM
2	Internationally Referenceable Agri Commodities*	10:00 AM	09:00 PM	09:30 PM
3	All Other Commodities	10:00 AM	05:00 PM	

\*Presently traded internationally referenceable Agri commodities are Crude Palm Oil, Cotton, Kapas Soya Oil and Sugar.

- III. With regard to Muhurat Trading on Diwali (Lakshmi Poojan) day, all National Commodity Derivatives Exchanges shall jointly decide the common trade timing and notify the same to the market under prior intimation to SEBI.
- IV. Exchanges shall ensure that they have necessary risk management system and infrastructure in place commensurate to their trading hours.

#### 2.1.2. Trading Holidays

- I. With regard to Trading holidays of National Commodity Derivatives Exchanges, all such Exchanges shall jointly decide

<sup>4</sup> SEBI Circular No. [SEBI/HO/CDMRD/DMP/CIR/P/2016/75](http://SEBI/HO/CDMRD/DMP/CIR/P/2016/75) dated August 30, 2016



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upon the common holiday list within the broad framework of the Negotiable Instruments Act, 1881 and also taking into consideration Central/State/Local holidays and notify the same to the market well in advance under prior intimation to SEBI.

On such trading holidays, National Exchanges may permit trading of internationally referenceable commodities in evening session i.e. post 5:00 PM, in case corresponding international markets are open.

- II. While finalizing Trading Holidays list, Exchanges shall suitably take into account the views of market participants. Frequent changes in holiday List shall be avoided i.e. once decided, same holidays should be followed every year irrespective of the holidays falling on a working day or a non-working day in that year.

## 2.2. Transaction Charges by Commodity Derivatives Exchanges<sup>5</sup>

- 2.2.1. The Commodity Derivatives Exchanges are collecting transaction charges from the members for the trades executed on their trading platform. In order to promote competition in the market and bring in greater efficiencies and lower transaction costs to market participants, it has been decided that the following norms shall be continued to be applicable to the Commodity Derivatives Exchanges while levying transaction charges-

- I. The Exchanges can levy different transaction charges for different commodities' contracts and even in the case of contracts of the same commodity.
- II. The Exchanges will ensure that the ratio between highest to lowest transaction charges in the turnover slab of any contract is not more than 2:1.<sup>6</sup>
- III. In the slab system the concessional transactional charges shall be charged only on the incremental volume/turnover and not on the entire volume/turnover.
- IV. The transaction charges are to be charged-on post-facto basis that is after the trades are executed.

- 2.2.2. It is also emphasized that, while revising the transaction charges, the Commodity Derivatives Exchanges shall also comply with the following guidelines:

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<sup>5</sup> SEBI Circular no [SEBI/HO/CDMRD/DMP/CIR/P/2016/82](#) dated September 07, 2016

<sup>6</sup> Revised via SEBI circular no [SEBI/HO/CDMRD/DMP/CIR/P/2018/1](#) dated January 03, 2018



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- I. The stock exchange system is capable of handling additional load.
- II. It does not affect the existing risk management system.
- III. It does not favour selective trades or selective category of investor.
- IV. It does not encourage generation of artificial demand.
- V. It does not result in any market irregularities.
- VI. It is uniformly applied to trades of similar nature.
- VII. It is imposed in fair and transparent manner

### 2.3. Spot Price Polling Mechanism<sup>7</sup>

- 2.3.1. The Commodity Derivatives Exchanges have been using a 'Spot Price Polling Mechanism' to arrive at the prevailing spot prices. Transparent discovery of spot prices is a critical factor in smooth running of futures market as the same are used as reference prices for settlement of contracts traded on the exchange platform. To arrive at the prevailing spot prices, the exchanges are polling the spot prices from various spot price polling participants. Some exchanges undertake this activity themselves whereas some have outsourced this work to an external agency.
- 2.3.2. In order to maintain the transparency of spot price polling process and dissemination of spot prices arrived at through spot price polling process, the commodity derivatives exchanges are directed to:
- I. have a well laid down and documented policy for the spot price polling mechanism.
  - II. display the spot price polling mechanism adopted for every contract on its website along with following details:

S. No.	Particulars	Details
1.	Details of the contract	
2.	Mechanism of spot price polling	
3.	How spot prices are arrived at	
4.	Whether these prices include or exclude taxes and other levies / costs	
5.	Whether spot prices polling has been outsourced to any external agency and if so, the details thereof.	

<sup>7</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/78](#) dated September 02, 2016



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S. No.	Particulars	Details
6.	Criteria for selection of these polling participants	
7.	Any other information that the Exchange may consider	

III. disclose, for every contract, following details with respect to individual spot price polling participants on its website:

Participants	Location	Profession	Price quoted	Time, Date
A <sub>1</sub>				
A <sub>2</sub>				

A. The Exchanges may assign a code such A1, A2, A3...etc. for polling participants of a particular contract and reveal his location and price (s) for the day.

B. This information shall be updated on Exchange website every day for every contract traded on the exchange platform.

C. The information shall continue to be displayed even after the expiry of the contract for a period of 3 years.

IV. endeavour in increasing the sample size used for fixing the daily spot prices during the last 15 days of the contract.

V. review on a monthly basis the prices polled by the participants to identify participants habitually polling unrealistic prices. These participants could be put under watch and subsequently removed from the panel if such instances reoccur despite appropriate communications.

VI. provide a separate feedback window for receiving complaints in this regard. The exchanges shall address such complaints in a time-bound manner. Further the exchanges shall keep the audit trail of all such complaints received and the steps taken for redressal.



#### **2.4. Criteria for Eligibility, Retention and re-introduction of derivative contracts on Commodities<sup>8</sup>**

2.4.1. The Commodity Derivatives Advisory Committee (CDAC), constituted for advising SEBI on matters concerning effective regulation and development of the commodity derivatives market, on the above aspects had inter alia, recommended that:

- I. The commodities which are to be recommended by SEBI for notification by the Government or on which the exchange proposes to launch a contract should pass through some test based upon the objective parameters and upon satisfaction, should be allowed for trading.
- II. It is also important that the contracts available for trading in the commodity derivatives market are liquid enough for the contracts to trade smoothly.

2.4.2. Though it may not be practicable to keep a strict objective criteria which may be uniformly applied across all commodities for inclusion under derivatives, a broad framework can certainly be laid down. Thus, based on the recommendation of CDAC and in consultation with the stakeholders, it has been decided that the following criteria for eligibility, retention and re-introduction of derivative contracts on commodities shall be followed by all national commodity derivatives exchanges ('exchange').

2.4.3. Eligibility criteria for allowing derivative contracts on commodities

- I. Exchanges shall examine following basic parameters and the commodity may be permitted to be included under derivatives if such commodity satisfies these parameters.

##### **A. Commodity Fundamentals**

- i. Size of the market / Volume of the market: The total supply value of the commodity in each year is taken as a measure of the physical market size of that commodity in that year. A higher physical market size could create higher futures trading volume by attracting more hedgers and speculators into the futures market.
- ii. Homogeneity/Standardization: The commodity should be either Homogeneous or should be conducive to standardization. This is required so that participants trading the commodity on exchange

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<sup>8</sup> SEBI Circular no. [SEBI/HO/CDMRD/DMP/CIR/P/2017/6](#) Dated January 20, 2017



platform should be able to unambiguously understand exactly what they are trading as on exchange only standardized contracts can be traded.

- iii. **Durable / Storable:** The commodity should be durable and storable for better price discovery. Durability i.e. higher shelf life makes commodity conducive for storage, which creates opportunity for cash and carry and hence would attract arbitragers thus make it more suitable for derivatives trading.

### B. Trade Factors

- i. **Global:** Global market in a commodity could be a positive indicator as internationally linked commodity prices are influenced by various global factors and thus create multiple reference points for price discovery which may make it conducive for derivatives trading.
- ii. **Value chain:** The term “value chain” describes the full range of value adding activities required to bring a product or service through the different phases of production, including procurement of raw materials and other inputs”, connected along a chain of producing, transforming and bringing goods and services to end-consumers through a sequenced set of activities and a strategic network among a number of business organizations”. Larger is the value chain larger would be the number of participants interested in derivatives trading of such commodity.
- iii. **Geographical coverage:** The commodity should ideally have a vast distribution across the country. The coverage can be in the form of production of commodity or the distribution of the commodity across the country. Higher coverage would attract higher number of participants to the derivatives.

### C. Ease-of- doing-business

- i. **Price Control:** Price controls are government mandated minimum or maximum prices that can be charged for specified goods. Government sometimes implements price controls when prices on essential items, such as food grain or oil are rising rapidly. Such goods which are prone to price control may be less conducive for derivatives markets
- ii. **Applicability of other laws:** The Food control Regulation Act, Essential commodities Act, APMC Act

etc., may have an impact on the commodities to be introduced for derivatives trading. Commodities which have excessive restrictions may be less conducive for derivatives markets.

#### **D. Risk management**

- i. **Correlation with International Market:** Commodities which have a strong correlation with the global market have higher need for price risk management. Such commodities are conducive for derivatives trading.
  - ii. **Seasonality:** The Indian commodity sphere is characterized by seasonality. The prices fluctuate with the supply season and the off season. The derivatives market is necessary to even out this fluctuation and facilitate better price discovery. Thus the commodities with higher seasonality are conducive for derivatives trading.
  - iii. **Price Volatility:** Commodities with high volatility of prices have high need for hedging. Such commodities are conducive for Derivatives trading.
- II. In order to bring in uniformity among the commodity derivatives exchanges, the indicative template as enclosed at **Annexure C** shall be adopted by the exchanges. In this regard the exchanges shall decide upon the specific numerical weight ages as approved by their oversight committee for 'Product Design'.
  - III. The exchanges shall also analyze all the proposed commodities/ commodity derivatives contracts on the aforesaid parameters comprised in the template and submit the same to SEBI while applying for the approvals along with necessary supporting documentary evidence.
- 2.4.4. Applicability of the template on the commodities presently being traded**
- I. As regards the commodities which are presently being traded on the exchange platforms, the exchanges shall apply the afore-said parameters comprised in the template on each of the commodities.
  - II. The results of such exercise is to be submitted to SEBI within a period of 3 months.

**2.4.5. Criteria for retention and reintroduction of derivative contracts on commodities**

- I. For any commodity to continue to be eligible for Futures trading on Exchange, it should have annual turnover of more than Rs.500 Crore across all National Commodity Derivatives Exchanges in at least one of the last three financial years. For validating this criteria, gestation period of three years is provided for commodities from the launch date/re-launch date, as may be applicable.
- II. Once, a commodity becomes ineligible for derivatives trading due to not satisfying the retention criteria, the exchanges shall not reconsider such commodity for re-launching contract for a minimum period of one year.
- III. Further, a commodity which is discontinued/suspended by the exchange from derivatives trading on its platform, shall not be re-considered by the concerned exchange for re-launching of derivatives contract on such commodity at least for a minimum period of one year.

**2.5. Unique Client Code (UCC) and Mandatory Requirement of Permanent Account Number (PAN)<sup>9</sup>**

- 2.5.1. It shall be mandatory for the members of the commodity derivatives exchanges to use Unique Client Code (UCC) for all clients transacting on the commodity derivatives exchanges. The commodity derivatives exchanges shall not allow execution of trades without uploading of the UCC details by the members of the exchange. For this purpose, members shall collect after verifying the authenticity and maintain in their back office the copies of Permanent Account Number (PAN) issued by the Income Tax Department, to all their clients.
- 2.5.2. PAN would be the sole identification number and mandatory for all entities/persons who are desirous of transacting on the commodity derivatives exchanges.

However, the investors residing in the State of Sikkim are exempted from the mandatory requirement of PAN. The exchanges should, however, ensure a system of proper verification to verify that such members / investors are residents of the State of Sikkim.

Further, PAN may not be insisted in the case of Central Government, State Government, and the officials appointed by the

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<sup>9</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/87](#) dated September 16, 2016

courts e.g. Official liquidator, Court receiver etc. (under the category of Government) for transacting in the securities market. The intermediary shall verify the veracity of the claim of the specified organizations, by collecting sufficient documentary evidence in support of their claim for such an exemption.

- 2.5.3. The commodity derivatives exchanges shall ensure that the members of their exchanges shall:
- I. collect copies of PAN cards issued to their existing as well as new clients after verifying with the original.
  - II. cross-check the aforesaid details collected from their clients with the details on the website of the Income Tax Department.
  - III. upload details of PAN so collected to the Exchanges as part of Unique Client Code.
  - IV. verify the documents with respect to the unique code and retain a copy of the document.
- 2.5.4. The Member shall also be required to furnish the above particulars of their clients to the commodity derivatives exchanges and the same would be updated on a monthly basis. Such information for a specific month should reach the exchange within 7 working days of the following month.
- 2.5.5. The commodity derivatives exchanges shall impose penalty on the member at the rate of 1% of the value of every trade that has been carried out by the member without uploading the UCC details of the clients. The penalty so collected by the Commodity Derivatives Exchanges shall be transferred to the Investor protection Fund (IPF).Further, if the client details are not uploaded within a month of the trade, the member is liable to be suspended.
- 2.5.6. The commodity exchanges shall be required to maintain a database of client details submitted by members. Historical records of all such submissions shall be maintained for a period of 7 years by the Exchanges.

## **2.6. Modification of Client Codes Post Execution of Trades on National and Regional Commodity Derivatives Exchanges<sup>10</sup>**

- 2.6.1. 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 in all

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<sup>10</sup> SEBI Circular no [SEBI/HO/CDMRD/DMP/CIR/P/2016/73](http://SEBI/HO/CDMRD/DMP/CIR/P/2016/73) dated August 19, 2016

segments. It is also re-emphasized here that this facility is expected to be used more as an exception rather than a routine.<sup>11</sup>

2.6.2. For this purpose the following shall be classified as genuine errors:

- I. Error due to communication and / or punching or typing such that the original client code / name and the modified client code / name are similar to each other
- II. Modification within relatives ('Relative' for this purpose would mean as defined under Companies Act, 2013)

2.6.3. Error Account

- I. Shifting of trades to the 'Error account' of broker would not be treated as modification of client code, provided that trades in 'Error account' are subsequently liquidated in the market and not shifted to some other code.
- II. Further, broker shall disclose the codes of accounts which are classified as 'Error accounts' to the Exchanges. Each broker should have a well-documented error policy approved by the management of the broker. Exchanges shall periodically review the trades flowing to the error accounts of the brokers.

2.6.4. If Exchange wishes to allow trading members to modify client codes of non-institutional trades, it shall

- I. lay down strict objective criteria (in line with the [Para '2.6.2' above](#)), with the approval of its Governing Board, for identification of genuine errors in client codes which may be modified, and disclose the same to market in advance,
- II. set up a mechanism to monitor that the trading members modify client codes only as per the strict objective criteria, and
- III. ensure that modification of client codes is covered in the internal audit of trading members.
- IV. shall not allow proprietary trades to be modified as client trades and vice versa.

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<sup>11</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/43](#) dated March 29, 2016



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- V. shall levy a penalty and collect from trading members and credit the same to its Investor Protection Fund as under:

'a' as % of 'b'	Penalty as % of 'a'
≤ 5	1
> 5	2

Where

a = Value (turnover) of non-institutional trades where client codes have been modified by a trading member in a segment during a month.

b = Value (turnover) of non-institutional trades of the trading member in the segment during the month

- VI. shall undertake stringent disciplinary actions against brokers who undertake frequent client code modifications. If 'a' as % of 'b', as defined above, exceeds 1% during a month, then 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. Appropriate disciplinary action shall be taken by the Exchange, if any deficiency is observed.

### 2.6.5. Waiver of Penalty

- I. Exchanges may waive penalty for a client code modification where broker is able to produce evidence to the satisfaction of the exchange to establish that the modification was on account of a genuine error. However, not more than one such waiver per quarter may be given to a broker for modification in a client code

Explanation: If penalty waiver has been given with regard to a genuine client code modification from client code AB to client code BA, no more penalty waivers shall be allowed to the stock broker in the quarter for modifications related to client codes AB and BA

- II. Exchanges shall submit a report to SEBI every quarter regarding all such client code modifications where penalties have been waived.



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2.6.6. SEBI shall examine the implementation of above mentioned norms during the inspection of stock Exchange.<sup>12</sup>

### 2.7. Daily Price Limit for Agricultural and Non-Agricultural Commodity Derivatives

#### 2.7.1. Agricultural commodity derivatives<sup>13</sup>

I. The following daily price limits have been decided upon:

Commodity	Initial Slab	Enhanced Slab	Total DPL
Barley, Chilli, Jeera, Turmeric	2%	2%	4%
Other Agricultural Commodities	3%	1%	4%

II. DPL shall have two slabs- Initial and Enhanced Slab. Once the initial slab limit is reached in any contract, then after a period of 15 minutes this limit shall be increased further by enhanced slab, only in that contract. The trading shall be permitted during the 15 minutes period within the initial slab limit. After the DPL is enhanced, trades shall be permitted throughout the day within the enhanced total DPL of 4%.

III. The above slab-wise DPL norm shall be applicable uniformly on all trading days.

#### 2.7.2. Non- Agricultural Commodity Derivatives<sup>14</sup>

I. Following slabs shall be applied for DPL of all non-agricultural commodity derivatives:

Name of Commodity	Initial Slab of DPL	1st Enhanced Slab of DPL	2nd Enhanced Slab of DPL	Aggregate DPL
Steel	4%	2%	Not Applicable	6%
Gold	3%	3%	3%	9%
Other Non-Agri Commodities	4%	2%	3%	9%

<sup>12</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/43](#) dated March 29, 2016

<sup>13</sup> SEBI circular no [CIR/CDMRD/DMP/2/2016](#) dated January 15, 2016

<sup>14</sup> SEBI circular no [SEBI/HO/CDMRD/DMP/CIR/P/2016/83](#) dated September 07, 2016



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### II. DPL for Gold and other non-agri commodities (excluding steel):

- A. DPL shall have three slabs as mentioned in table above. Once the trade hits the prescribed Initial slab, the DPL shall be relaxed further by '1<sup>st</sup> Enhanced Slab' without any cooling off period in the trading. In case, '1<sup>st</sup> Enhanced Slab' is also breached, then after a cooling off period of 15 minutes, the DPL shall be further relaxed by '2<sup>nd</sup> Enhanced Slab'.
- B. During cooling off periods trading shall continue to be permitted within the previous slab of DPL.
- C. In case price movement in referenceable international market is more than the aggregate DPL, the same may be further relaxed in steps of 3% by Exchanges. Exchanges shall immediately inform Integrated Surveillance Department (ISD) of SEBI about any such relaxation of DPLs beyond Aggregate DPL, along with all the relevant details and justification.

### III. DPL for Steel shall have two slabs as mentioned in table above. Once the trade hits the prescribed initial slab, the DPL shall be relaxed further by '1<sup>st</sup> Enhanced Slab' (i.e. 2%) after a cooling off period of 15 minutes. During cooling off periods trading shall continue to be permitted within the previous slab of DPL. There shall not be further relaxation of DPL during that day.

#### 2.7.3. DPL on First Trading Day of the Contract (For Agri/Non-Agri Commodity Derivatives)<sup>15</sup>

- I. For fixing DPL slabs, base price shall be taken as previous day's closing price of the contract, however for the first trading day (launch day) of each contract, Exchange shall determine base price as under :
  - A. Volume Weighted Average Price (VWAP) of the first half an hour, subject to minimum of ten trades
  - B. If sufficient No. of trades are not executed during the first half an hour, then the VWAP of first one hour trade subject to minimum of ten trades.
  - C. If sufficient No. of trades are not executed even during the first hour of the day then VWAP of the first ten trades during the day

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<sup>15</sup> SEBI circular no [SEBI/HO/CDMRD/DMP/CIR/P/2016/83](#) dated September 07, 2016



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- D. The base price arrived as per (A) or (B) or (C) above, as the case may be, shall be calculated by the Exchange and shall be used to determine DPL for the remaining part of the day
- 2.7.4. For any commodity derivatives, exchanges at their discretion may prescribe DPL narrower than the slabs prescribed by SEBI in case they require so based upon their analysis of price movements and their surveillance findings.

## 2.8. Suspension of Forward Segment<sup>16</sup>

- 2.8.1. It has been decided that participants in Forward Segment shall not be allowed to enter into fresh contracts till further orders.

## 2.9. Options on Commodity Futures- Product Design<sup>17</sup>

- 2.9.1. **Eligibility criteria for selection of underlying Commodity Futures for Options:** Options would be permitted for trading on a commodity derivatives exchange only on those commodity futures as underlying, which are traded on its platform and satisfy both the criteria specified below on the respective exchange:
- I. The underlying 'Futures contracts' on the corresponding commodity shall be amongst the top five futures contracts in terms of total trading turnover value of previous twelve months;
  - II. The average daily turnover of underlying futures contracts of the corresponding commodity during the previous twelve months, shall be at least :
    - A. INR 200 crore for agricultural and agri-processed commodities
    - B. INR 1000 crore for other commodities.

- 2.9.2. **Product Design for Options on Commodity Futures:** The product design framework would be in conformity with the guidelines prescribed below:

- I. **Underlying:** Commodity futures contract (of a specified month) traded on the corresponding exchange.

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<sup>16</sup> SEBI circular no [CIR/CDMRD/DMP/2/2016](#) dated January 15, 2016

<sup>17</sup> SEBI circular no [SEBI/HO/CDMRD/DMP/CIR/P/2017/55](#) dated June 13, 2017



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II. **Settlement Method:** On exercise, option position shall devolve into underlying futures position as follows:-

- A. long call position shall devolve into long position in the underlying futures contract
- B. long put position shall devolve into short position in the underlying futures contract
- C. short call position shall devolve into short position in the underlying futures contract
- D. short put position shall devolve into long position in the underlying futures contract

All such devolved futures positions shall be opened at the strike price of the exercised options.

III. **Exercise Style:** To begin with European Style options are permitted.

IV. **Minimum Strikes:** Each option expiry shall have minimum three strikes available viz., one each for In the Money (ITM), Out of the Money (OTM) and At the Money (ATM).

### V. **Exercise Mechanism:**

On expiry, following mechanism shall be adopted by Exchanges for exercise of the options contracts:

- A. Option series having strike price closest to the Daily Settlement Price (DSP) of Futures shall be termed as At the Money (ATM) option series.

This ATM option series and two option series having strike prices immediately above this ATM strike and two option series having strike prices immediately below this ATM strike shall be referred as 'Close to the money' (CTM) option series.

In case the DSP is exactly midway between two strike prices, then immediate two option series having strike prices just above DSP and immediate two option series having strike prices just below DSP shall be referred as 'Close to the money' (CTM) option series.



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- B. All option contracts belonging to 'CTM' option series shall be exercised only on 'explicit instruction' for exercise by the long position holders of such contracts.
  - C. All In the money (ITM) option contracts, except those belonging to 'CTM' option series, shall be exercised automatically, unless 'contrary instruction' has been given by long position holders of such contracts for not doing so.
  - D. All Out of the money (OTM) option contracts, except those belonging to 'CTM' option series, shall expire worthless.
  - E. All exercised contracts within an option series shall be assigned to short positions in that series in a fair and non-preferential manner.
- VI. **Trading Hours:** Trading hours shall be same as those of corresponding futures contract.
- VII. **Expiry Day:** Expiry day of options contracts shall be decided by Exchange based upon period of high liquidity of underlying futures contract and shall be part of option contract specifications.
- VIII. **Position Limits:**
- A. Position limits for options shall follow the same norms as provided for futures.
  - B. Position limits of options would be separate from position limits of futures contracts and numerical value for client level/member level limits shall be twice of corresponding numbers applicable for futures contracts.
  - C. Due to separate position limits for options, there is a possibility that post exercise of options i.e. after devolvement of options into corresponding futures positions open positions for clients/members may exceed their permissible position limits for future contracts. For such clients/members Exchanges may permit maximum up to two trading days post option expiry day to reduce their futures positions to bring them within the permissible position limits.
- 2.9.3. It is decided that initially, on a pilot basis each exchange shall be allowed to launch options on futures of only one commodity that meets the criteria prescribed above.

2.9.4. The Commodity derivatives exchanges willing to start trading in options contracts shall take prior approval of SEBI for launching such contracts

## **2.10. Position Limits for Agricultural and Non- Agricultural Commodity Derivatives/Hedgers**

### **2.10.1. General Norms For Position Limits<sup>18</sup>**

The following norms shall be applicable to the Agricultural as well as Non- Agricultural commodity derivatives at commodity level:

- I. Numerical value of overall client level open position limits, shall be applicable for each commodity as explained subsequently.
- II. The Exchanges, however, in their own judgment, may prescribe limits lower than what is prescribed by SEBI by giving advance notice to the market under intimation to SEBI.
- III. For the purpose of position limits, norms applicable on client level positions shall also be applicable to the proprietary positions of trading members and while calculating member's open positions, his proprietary positions shall be treated and computed like a client's positions.
- IV. For the purpose of calculating overall position of a member, the overall position of its all clients (as determined in Clause '[2.10.2\(I\) or 2.10.3 \(I\)](#)' below) shall be added without netting off among themselves as also against proprietary positions of the member. Thus, all long clients and all short clients shall be added up separately and higher of the two shall be reckoned as Member's open position in a commodity derivative.

### **2.10.2. Agricultural Commodity Derivatives<sup>19</sup>**

Following norms shall be applicable on Agricultural commodity derivatives at commodity level:

- I. For the purpose of calculating positions of a client, all long and short positions of the client across all contracts shall be

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<sup>18</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/96](#) dated September 27, 2016

<sup>19</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/96](#) dated September 27, 2016



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added up separately and higher of the two shall be considered as his overall open position.

- II. For determination of numerical value of overall client level open position limits, following framework is prescribed for agricultural commodities<sup>20</sup>:

A. **Categorization of commodities:** In any given year, based on the average of production data and import data of past five years on a rolling basis and keeping in view various extraneous factors that affect the trading in derivatives, the agricultural commodities shall be classified into three categories viz., sensitive, broad and narrow as below:-

- i. **Sensitive commodity:** An agricultural commodity shall be classified as a sensitive commodity if it:
  - a. is prone to frequent Government/External interventions. These interventions may be in the nature of stock limits, import/export restrictions or any other trade related barriers; or
  - b. has observed frequent instances of price manipulation in past five years of derivatives trading
- ii. **Broad Commodity:** An agricultural commodity shall be classified as 'Broad Commodity' if it is not 'Sensitive Commodity' and satisfies following criteria;
  - a. Average deliverable supply for past five year is at least 10 lakh Metric Ton (MT) in quantitative term and is at least INR 5,000 Crore in monetary term.
- iii. **Narrow Commodity:** An agricultural commodity which is not falling in either of the above two categories, viz 'Sensitive' or 'Broad' commodity, shall be classified as 'Narrow Commodity'

B. **Deliverable Supply:** The deliverable supply for an agricultural commodity would be "Production + Imports"

C. **Client Level Numeric Position Limits:** Numerical Value of overall client level open position limits for each commodity shall be calculated from 'deliverable supply'

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<sup>20</sup> Revised via SEBI circular [SEBI/HO/CDMRD/DMP/CIR/P/2017/84](#) dated July 25, 2017



available in a particular year, as per its category as given below:

Category of Commodity	Position limits
Broad	1% of the deliverable supply
Narrow	0.5% of the deliverable supply
Sensitive	0.25% of the deliverable supply

The numbers arrived based upon above formula should be rounded off downward to appropriate number of zeroes.

**D. Yearly Categorization of commodities and computation of position limits:**

- i. All the national commodity derivatives exchanges shall jointly classify agricultural commodities into the afore-stated three categories on annual basis as per the principles indicated at para [No. II\(A\) above](#).
- ii. Whenever an agricultural commodity of 'narrow' category is required to be re-categorized to 'broad' in subsequent years, such re-categorization may be possible only if both, average deliverable supply of such commodity for the past five years and monetary value thereof as mentioned at Para '[II\(A\)\(ii\)\(a\)](#)' exceeds by more than 5%.
- iii. For determination of '**deliverable supply**' of various agricultural commodities for each year, the national commodity derivatives exchanges shall take into account the latest production figures of such commodities as annually declared by relevant government sources or from the latest 'third advance estimates' of agricultural commodities published by the Ministry of agriculture or any other yearly estimates/assessments of production and imports made by any governmental agencies such as Ministry of Agriculture, Ministry of Textiles, Ministry of Commerce, different statutory boards/associations etc., concerned with different agricultural commodities. The national commodity derivatives exchanges shall indicate the sources from which the production and import / export data have been obtained for the purpose of determination of 'deliverable supply' of different agricultural commodities.



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- iv. Every year, for each agricultural commodity that is being traded in the derivatives market, all national commodity derivatives exchanges shall jointly complete the exercise of determination of 'deliverable supply, categorization/re-categorization of commodities and computation of numerical value of position limits. Numerical values of position limits for any agricultural commodity shall be revised only if the computation results in a revision in the value by at least 5% compared to previous year's limits. Exchanges shall, after prior intimation to SEBI, notify such details to the market through their respective websites sufficiently in advance and latest by **31<sup>st</sup> of July** (unless extended by SEBI under exceptional circumstances) of every year and revised limits shall become applicable for all running contracts with effect from **1<sup>st</sup> of September** of every year
  - v. **Dissemination of Information on Website:** In order to provide necessary information to the stakeholders the Exchanges shall prominently disseminate on their websites the details of five year average deliverable supply, current year deliverable supply, source of data, categorization of the commodity, position limits etc. for each of the commodity traded on their exchange, as per the format given in **Annexure D.**<sup>21</sup>
  - vi. In the interest of trade and public, SEBI may exercise its due discretion in modifying the aforesaid position limits at any time during the year.
- III. The overall member level position limits across all contracts shall be 10 times the numerical value of client level position limit or 15% of the market-wide open interest, whichever is higher.
- IV. Near Month Position Limits :** In case of near month contracts:
- A. Client level position limits shall be equivalent to the one fourth of the overall Client level position limit as prescribed in **II under 2.10.2** above.
  - B. Member level position limits shall also be equivalent to the one fourth of the overall member level position limit.
  - C. For calculating near month open position of a client, higher of long and short positions of the client in near month

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<sup>21</sup> Added via SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2018/96](http://SEBI/HO/CDMRD/DMP/CIR/P/2018/96) dated June 11, 2018

contracts to be considered. Thus, netting out near month contract with off-setting positions in far months contracts shall not be permitted for the purpose of computation of near month position of any client.<sup>22</sup>

- D. For calculating near month open position of a member, the position of the clients as determined in **IV (C)** above will be added without netting off among themselves as also against proprietary position of the member (which will also be treated like a client position). All longs and shorts will be added up separately and higher of the two will be reckoned.<sup>23</sup>

- V. **Exchange-wide Position Limit for Agricultural Commodities:** The overall Exchange-wide gross position limit on open interests shall be 50% of its 'deliverable supply' determined for the relevant year, which shall also be jointly notified by Exchanges along with client level numerical limits.<sup>24</sup>

#### 2.10.3. Non-Agricultural Commodity Derivatives<sup>25</sup>

The following norms shall be applicable to Non- Agricultural commodity derivatives at commodity level:-

- I. For the purpose of calculating overall position of a client, all long and short positions of the client across all contracts shall be netted out.
- II. Client level position limits shall be equivalent to the numerical level limit as given in table in **Annexure E** or 5% of market-wide open interest, whichever is higher.
- III. Member level position limits shall be 10 times of the numerical value of client level position limits or 20% of the market-wide open interest, whichever is higher.

#### 2.10.4. Clubbing of Open Positions<sup>26</sup>

- I. While calculating open positions for the purpose of position limits, Exchanges shall take suitable measures for clubbing of open positions of clients/members who may be acting in concert to circumvent the norms of position limits. The broad guidelines for clubbing of open positions are provided in **Annexure F** to the circular.

<sup>22</sup> SEBI circular no. [CDMRD/DMP/CIR/32/2016](#) dated January 29, 2016

<sup>23</sup> SEBI circular no. [CDMRD/DMP/CIR/32/2016](#) dated January 29, 2016

<sup>24</sup> Revised via SEBI circular [SEBI/HO/CDMRD/DMP/CIR/P/2017/84](#) dated July 25, 2017

<sup>25</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/96](#) dated September 27, 2016

<sup>26</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/96](#) dated September 27, 2016

- II. In this regard all national commodity derivatives exchanges are directed to jointly formulate a uniform guidelines and disclose the same to the market.

#### 2.10.5. Monitoring of Position Limits<sup>27</sup>

Exchanges shall monitor the open position on a real time basis, and shall endeavor that no client or member breaches the open position limits 'at end of the day' as well as 'during intra-day trading'. Penalty shall be levied on those breaching the position limits at end of the day as well as during intra-day trading as provided in **Annexure G**.

#### 2.10.6. Position Limit For Hedgers<sup>28</sup>

- I. In order to facilitate larger participation by genuine hedgers by providing them with necessary incentives with a view to deepen the commodity derivatives market, the exchanges shall stipulate a Hedge Policy for granting hedge limits to their members and clients. The Exchanges shall widely publicize their respective hedge policy by holding awareness programmes for the target participants and making it publicly available on their website.
- II. In this regard, the Exchanges shall adhere to the following broad guidelines while granting hedge limit Exemptions to their members and clients:
- A. The hedge limit to be granted by the Exchanges to the bona fide hedgers shall be in addition to the normal position limit allowed to it. Such hedge limit is non-transferrable and shall be utilized only by the Hedger to whom the limit has been granted and not by anyone else
- B. This hedge limit granted for a commodity derivative shall not be available for the near month contracts of the said commodity from the date of applicability of near month limit
- C. Hedge limits for a commodity shall be determined on a case to case basis, depending on applicant's hedging requirement in the underlying physical market based upon his/its Export or import commitments/ Stocks held/ Past track record of Production or Purchase or Sales/Processing capacity and other factors as the Exchanges may deem appropriate.

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<sup>27</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/96](#) dated September 27, 2016

<sup>28</sup> SEBI Circular NO. [SEBI/HO/CDMRD/DMP/CIR/P/2016/71](#) dated August 19, 2016



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- D. The Exchanges shall undertake proper due diligence by verifying documentary evidence of the underlying exposure and ensuring that the hedge limit granted is genuine and does not have the potential to disturb the equilibrium of the market of that particular derivative contracts.
- E. The hedge limit may also be made available in respect of the short open position acquired by an entity for the purpose of hedging against the stocks of commodities owned by it and,
- i. pledged with the Scheduled Commercial Banks/Co-operative Banks
  - ii. lying in any Government Entity's warehouse/ WDRA Approved warehouses or
  - iii. lying in any other premises (warehouse, factory etc.), provided the premises is either owned by the hedger or taken on lease by the hedger in its name and Exchange has ascertained that such premises are well equipped with quality control safeguards for storage of the relevant commodity
- and shall be subject to the production of the relevant Bank Certificate/Warehouse Receipt, as the case may be, and also shall be subject to verification regarding ownership of the stocks etc., by the Exchange in accordance with the procedure laid down by the Exchange in this regard.
- F. At any point of time during the hedge period, hedging positions taken in derivatives contracts by hedger, across multiple Exchanges/ Contracts, shall not exceed his/its actual/anticipated exposure in the physical market, even if there is a usable hedge limit available as per allocation made by the Exchanges to the hedger.
- G. If under any circumstances a hedger is found availing hedge limit in contrary to the guideline framed by the SEBI/Exchanges or submits false document or fails to inform Exchange timely about reduction of underlying exposure based upon which it has been allocated hedge limit by Exchange, it shall be liable for expulsion from membership/prohibition from trading as the case may be. Such action shall be without prejudice to other disciplinary actions including penalties prescribed by Exchanges.
- H. A Hedger having availed of benefit of hedge limits, shall preserve relevant records for a period of minimum three years for inspection by SEBI/Exchange.



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- I. The hedge limit approved by an exchange shall be valid for a period as mentioned in the approval letter and such hedge limit shall stand cancelled automatically upon expiry of such period without any notice.
  
- J. The Exchanges shall disclose on their website the hedge position allocated to various hedgers, indicating the period for which approval is valid, in an anonymous manner. The disclosure shall be made in the following format:

Sr.	Name of the Commodity	Hedge r	Long Hedge Limit s	Short Hedge Limit s	Date of making application	Application Approval Date	Approval Start Date	Date till Approval is valid
1.		Hedger 1						
2.		Hedger 2						

### 2.11. Requirements for Commodity Derivative Exchanges on their Websites<sup>29</sup>

2.11.1. To promote transparency in the markets, Exchanges shall disclose following info their website:

- I. Position of top 10 trading clients in buy side as well as sell side in order of maximum open interest in anonymous manner every day after the end of trading session
  
- II. The delivery intent of the hedgers on a daily basis in an anonymous manner
  
- III. The pay-in and pay-out of commodities made by top 10 clients including hedgers 10 days after completion of settlement, for the information of the market
  
- IV. Their members' proprietary position on monthly basis. The disclosure shall include average daily proprietary position (during the month) as a percentage of member's average daily total position (including clients) and average daily margin on proprietary position (during the month) as a percentage of margins on member's average daily total position (including clients)

<sup>29</sup> SEBI circular no [SEBI/HO/CDMRD/DMP/2016/101](#) dated September 27, 2016

- V. The percentage of proprietary trade and client trade done and also specify as to what percentage of this trade is by algorithmic trading/HFT. This information shall be displayed before opening of the markets on the next day.
  - VI. Members' data as mentioned in **Annexure H**.
  - VII. List of the members whose request of surrender has been approved by the Exchange, along with date of approval
  - VIII. Break up of funds contributed into Settlement Guarantee Funds and will be updated on quarterly basis
  - IX. Disclosure of information regarding trading activity during life cycle of contract as mentioned in **Annexure I**.
- 2.11.2. The Exchanges which are suspending/expelling/declaring defaulter their members for irregularities/violation of regulatory measures and other various reasons, shall disclose following information on their website-
- I. The details of member (Name, Address, Names of Promoters/Owners/Partners/Directors of Company, Registration No. etc.)
  - II. The details of disciplinary action taken by the Exchange
- 2.11.3. These disclosure requirements are in addition to those disclosure mandated in various circular issued by SEBI wherein the exchanges are required to make requisite disclosures

#### **2.12. Disclosure of Proprietary Trading by Commodity Derivatives Broker to Client<sup>30</sup>**

- 2.12.1. With a view to increase the transparency in the dealings between the broker and the client, it has been decided that every broker shall disclose to his client whether he does client based business or proprietary trading as well.
- 2.12.2. The broker shall disclose the aforesaid information to his existing clients within a period of one month from the date of this circular.
- 2.12.3. Further, the broker shall disclose this information upfront to his new clients at the time of entering into the Know Your Client agreement.

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<sup>30</sup> SEBI Circular no [SEBI/HO/CDMRD/DMP/CIR/P/2016/49](http://SEBI/HO/CDMRD/DMP/CIR/P/2016/49) dated April 25, 2016

- 2.12.4. In case of a broker who at present does not trade on proprietary account, chooses to do so at a later date, he shall be required to disclose this to his clients before carrying out any proprietary trading

#### **2.13.“Pro – account” Trading Terminals<sup>31</sup>**

- 2.13.1. Facility of placing orders on “pro-account” through trading terminals shall be extended only at one location of the members as specified / required by the members
- 2.13.2. 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.
- 2.13.3. 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 exchange stating the reason for using the “pro-account” at multiple locations and the 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.
- 2.13.4. Exchanges are directed to take necessary disciplinary action wherever such facility is being misused by any member.

#### **2.14.Participation of category III Alternative funds (AIFs) in Commodity Derivatives Market<sup>32</sup>**

- 2.14.1. Category-III Alternative Investment Funds (AIFs) are allowed to participate in the commodity derivatives market subject to the following conditions:
- i. Category III AIFs may participate in all commodity derivatives products that are being traded on the commodity derivatives exchanges as ‘clients’ and shall be subjected to all the rules, regulations and instructions, position limit norms as may be applicable to clients, issued by SEBI and Exchanges from time to time.
  - ii. Category III AIFs shall invest not more than ten percent of the investable funds in one underlying commodity.

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<sup>31</sup> SEBI Circular no [SEBI/HO/CDMRD/DMP/CIR/P/2016/49](#) dated April 25, 2016

<sup>32</sup> SEBI Circular No [SEBI/HO.CDMRD/DMP/CIR/P/2017/61](#) dated June 21, 2017

- iii. Category III AIFs may engage in leverage or borrow subject to consent from the investors in the fund and subject to a maximum limit, as specified by the Board from time to time.
- iv. Category III AIFs shall make disclosure in private placement memorandum issued to the investors about investment in commodity derivatives. Consent of existing investor(s) shall be taken by AIFs if they intend to invest in commodity derivatives and exit opportunity should be provided to dissenting investor(s).
- v. If applicable, AIF shall also comply with RBI notification No. [FEMA. 355/2015-RB](#) dated November 16, 2015 and all other guidelines issued by the RBI under Foreign Exchange Management Act, 1999 from time to time.
- vi. Category III AIF shall be subject to the reporting requirements as may be specified by SEBI.
- vii. The participation of Category III AIF in the commodity derivatives market shall be subject to the compliance of the provisions of SEBI (Alternative Investment Funds) Regulations, 2012 and circulars issued thereunder.

## **2.15.Role of Independent Oversight Committee for Product design <sup>33</sup>**

2.15.1. In order to bring uniformity with respect to the role of the oversight committee on product design, and after having discussions with commodity derivatives exchanges on this issue, it is decided that the functions of the oversight committee for 'Product Design' in all the commodity exchanges shall be as under-

- I. To oversee matters related to product design such as introduction of new products/contracts, modifications of existing product/contract designs etc. and review the design of the already approved and running contracts.
- II. To oversee SEBI inspection observation on Product Design related issues.
- III. To estimate the adequacy of resources dedicated to Product design related function.

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<sup>33</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2018/12](#) dated January 22, 2018

2.15.2. The head(s) of department(s) handling the above matters shall report directly to the committee and also to the Managing Director. Any action of the Exchange against the aforesaid head(s) shall be subject to an appeal to the committee, within such period as may be determined by the governing board.

**2.16. Sharing of Information in Case of declaration of Member as defaulter in case of Multiple Membership<sup>34</sup>**

- 2.16.1. Whenever a member of any segment is declared defaulter, the concerned Stock Exchange/Clearing Corporation shall immediately declare it a defaulter in all its segments. It shall also immediately inform all other Stock Exchanges/Clearing Corporations the details of the defaulter member such as name of the member, the names of the proprietors/ partners/ promoters/ dominant shareholders, as applicable.
- 2.16.2. Immediately on receipt of the information about default of a member, the other Stock Exchange / Clearing Corporation shall declare the said member defaulter on all its segments.
- 2.16.3. The Stock Exchanges / Clearing Corporations shall take appropriate action against the associates of defaulter member. For this purpose, the term 'associate' shall include a person:
- I. who, directly or indirectly, by itself, or in combination with other persons, exercises control over the member, whether individual, body corporate or firm or holds substantial share of not less than 15% in the capital of such entities;  
or
  - II. in respect of whom the member, individual or body corporate or firm, directly or indirectly, by itself or in combination with other persons, exercises control;  
or
  - III. whose director or partner is also a director or partner of the member, body corporate or the firm, as the case may be.

Explanation: The expression "control" shall have the same meaning as defined under clause (e) of Regulation 2 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

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<sup>34</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/102](#) dated September 27, 2016

**2.17. Broad guidelines on Algorithmic Trading for National Commodity Derivatives Exchanges<sup>35</sup>**

- 2.17.1. Any order that is generated using automated execution logic shall be known as algorithmic trading.
- 2.17.2. The commodity exchanges shall have arrangements, procedures and system capability to manage the load on their systems in such a manner so as to achieve consistent response time to all members. The capacity of the trading system of the Exchange should be at least four times the peak order load encountered and the Exchange system should be upgraded on a regular basis. The exchange shall continuously study the performance of its systems and, if necessary, undertake system upgrade, including periodic upgrade of its surveillance system, in order to keep pace with the speed of trade and volume of data that may arise through algorithmic trading.
- 2.17.3. While approving the algorithmic trading, the Exchanges shall ensure that:
  - I. There is clear classification of algorithmic orders in terms of CTCL terminal code/ATS User ID approved by the Exchange for algorithmic trading.
  - II. The orders of clients are routed through member server only and client orders are not placed directly to the Exchange System.
  - III. The Exchanges shall not approve algorithms that may not be conducive to efficient price discovery or fair play.
  - IV. The Exchange shall subject the systems of the members to initial conformance tests and ensure that the checks mentioned in these guidelines are in place.
  - V. Immediate Or Cancel (IOC) orders shall not be allowed to be placed using algorithmic trading.
  - VI. The algorithms which will ‘take liquidity’ away from the market shall not be approved. While approving algorithmic strategies, Exchanges shall record the reason as to why such strategy is allowed and how it will induct more liquidity in the contract system. Exchanges shall also make half yearly review of effect

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<sup>35</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/97](#) dated September 27, 2016



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of the approved strategies on liquidity and would discontinue / disapprove any strategy which fails to induct liquidity.

- 2.17.4. As mini and micro contracts are targeted towards small participants, while allowing algorithmic trading in mini and micro contracts Exchange should exercise caution and permit algorithmic trading only after taking into account liquidity in the contract and ascertaining that it will not put small participants in disadvantage.
- 2.17.5. Co-Location, Co-Hosting or any other facility or arrangement which puts some members in disadvantageous position vis-à-vis other members shall not be allowed. Algorithmic trading shall not be permitted from Exchange hosted CTCL terminals.
- 2.17.6. In order to ensure orderly trading in the market and fair usage of the trading platform by all the members, Exchanges shall put in place the following economic disincentives for daily algorithmic order-to-trade ratio:

Member-wise Daily Order-to-Trade Ratio (X)	Charges (Per order)
Up to 50	NIL
50 to less than 250 (on incremental basis)	1 paise
250 to less than 500 (on incremental basis)	5 paise
500 or more than 500 (on incremental basis)	5 paise

- I. In case the ratio is 500 or more than 500 during a trading day, the concerned member shall not be permitted to place any order for the first 15 minutes on the next trading day (in the continuous trading session) as a cooling off action . However, the trading member shall be permitted to enter transaction in risk reducing mode during such a cooling off period.
- II. For the purpose of calculation of daily Order-to-trade ratio, all algorithmic orders, i.e. order entry, order modifications and order cancellation shall be considered.
- III. The algorithmic orders entered and /or modified within 1 % of the last traded price (LTP) of the respective contract shall not be included in the calculation of the Order-to-Trade ratio for the purpose of arriving at the penalty for higher order-to-trade ratio.
- IV. The penalty structure will be applicable for only those members who have placed 10,000 orders or more in a day.
- V. The exchange shall put in place monitoring systems to identify and initiate measures to impede any possible instances of order flooding by algorithmic trading.

- 2.17.7. The exchanges shall place a limit (X) on the numbers of orders per second from a particular CTCL ID/ATS User-ID not exceeding hundred orders per second. Compliance with the limit "X" so set by a particular CTCL ID/ATS User-ID shall be measured over a rolling period of five seconds (i.e., 5X orders for 0th–5th second, 5X orders for 1st-6th second, 5X orders for 2nd to 7th second and so on).
- 2.17.8. For number of orders exceeding the limit (X) set by the exchange, the exchange shall prescribe economic disincentives and shall inform the same to SEBI.<sup>36</sup>
- 2.17.9. The exchanges shall ensure that all algorithmic orders are necessarily routed through members servers located in India and through specified CTCL ID/ATS User-ID approved by exchange for algorithmic trading. The exchanges shall also ensure that these have no interlink with any system or ID located/ linked outside India.
- 2.17.10. The exchange shall have appropriate multi-layer risk control mechanism to address the risk emanating from algorithmic orders and trades. The minimum order –level risk controls shall include the following.
- I. Market orders shall not be allowed to be placed using algorithmic trading, only limit orders shall be allowed.
  - II. Daily Price Limit check: The price quoted by the order shall not violate the daily price limit specified for the contract.
  - III. Maximum order size check: The quantity quoted in the order shall not violate the maximum order size limit defined in the contract specifications.
  - IV. Net open position check: The quantity quoted in the order shall not violate the position limits at member level and client level.
  - V. Market Price Protection: Within the daily price limit, the exchanges may prescribe any other limit which may be a pre – set percentage of LTP.
- 2.17.11. In the interest of orderly trading and market integrity, the exchanges shall put in place a system to identify dysfunctional algorithms (i.e. algorithms leading to loop or runaway situation) and take suitable measures , including advising the member, to shut down such algorithms and remove any outstanding orders in the system that have emanated from such dysfunctional algorithms. Further, in exigencies, the exchange should be in a position to shut down the member's terminal.

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<sup>36</sup> Revised via SEBI circular no [SEBI/HO/CDMRD/DRMP/CIR/P/2018/60](#) dated April 03, 2018

- 2.17.12. The exchange may seek details of algorithmic strategies to be used by the members for purposes of inquiry, surveillance, investigation etc.
- 2.17.13. Any event leading to slow down or trading halt or any other abnormal development shall be immediately reported to Integrated Surveillance Department of SEBI with full details.
- 2.17.14. The Exchanges shall ensure that the member shall provide the facility of algorithmic trading only upon the prior written permission of the exchange. While considering such approval, the exchanges shall ensure that the controls specified in these guidelines are fully implemented by the member.
- 2.17.15. The other risk management checks already put in place by the exchange shall continue and the exchange may re-evaluate such checks if deemed necessary in view of algorithmic trading.
- 2.17.16. Exchange shall have an effective surveillance mechanism to ensure that only approved algorithmic strategies are used.
- 2.17.17. The Exchanges shall further ensure that their members providing the facility of algorithmic trading comply with the provisions of these guidelines. The exchange shall specifically ensure that.
- I. The members maintain sufficient deposits / funds for margin/ settlement obligations, in respect of the trades effected through algorithmic facility, whether on own account or client's account and that algorithmic trading does not result in shortages in margin deposit or settlement obligation.
  - II. The member's trades routed through algorithmic trading are not in the nature of abnormal / manipulative trades.
  - III. The annual compliance report as submitted by member to the exchange includes a specific system audit report of the algorithmic trading ensuring that the checks are in place. System Audit of algorithmic trading shall be undertaken by a system auditor who possess any of the following certifications<sup>37</sup> :
    - A. CISA (Certified Information System Auditors)from ISACA (Information Systems Audit and Control Association)

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<sup>37</sup> Revised via SEBI circular no [SEBI/HO/CDMRD/DRMP/CIR/P/2018/60](http://SEBI/HO/CDMRD/DRMP/CIR/P/2018/60) dated April 03, 2018



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- B. DISA (Post Qualification Certification in Information System Audit ) from Institute of Chartered Accountants of India (ICAI);
  - C. CISM (Certified Information Securities Manager) from ISACA;
  - D. CISSP ( Certified Information System Security Professional) from International Information Systems Security Certification Consortium , commonly known as (ISC).
- IV. Further, the exchange shall subject the member systems to more frequent system audits, as required.
- V. The members have the capability to set up and apply the necessary risk control checks at the individual order level and client level before each order generated by the algorithmic trading is released to the trading system and implements the following minimum level of checks:
- A. Daily Price Limit: Orders are not released in violation of the daily price limit defined in the contract specification or any other limit which may be prescribed by the Exchange.
  - B. Maximum Order Size: Order are not released in violation of the maximum order size limit defined in the contract specification.
  - C. Position limit: The net position of the client / member are not in violation of the position limits prescribed for the respective commodity.
  - D. An algorithmic trading shall account for all executed, unexecuted and unconfirmed orders, placed by it before releasing further order(s). Further, the algorithmic system shall have pre-defined parameters for an automatic stoppage in the event of algorithmic execution leading to a loop or a runaway situation. The member shall have system to identify dysfunctional algorithms.
  - E. All algorithmic orders are tagged with a unique identifier provided by the exchange in order to establish audit trail.
- VI. The Exchange shall ensure that the member, desirous of placing orders using algorithms, submit to the exchange an undertaking that-
- A. The member has proper procedures, systems and technical capability to carry out trading through the use



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of algorithms and to safeguard algorithms from misuse or unauthorized access.

- B. The member has real-time monitoring systems to identify algorithms that may not behave as expected. Member shall keep exchange informed of such incidents immediately.
- C. The member shall maintain logs of all trading activities to facilitate audit trail.
- D. The member shall maintain record of control parameters, orders, trades and data points emanating from trades executed through algorithm trading.
- E. The member shall obtain prior approval of the exchange on any modification or change to the approved algorithms or systems used for algorithms. The Exchange shall ensure conformance of such modified algorithms or systems also to the requirements specified in these guidelines.

2.17.18. The Exchange shall report details regarding algorithmic trading to SEBI in its Monthly Development Report inter-alia incorporating turnover details of algorithmic trading , algorithmic trading as percentage of total trading, number of members/ clients using algorithmic trading, action taken in respect of dysfunctional algos, status of grievances if any, received and processed, etc.

### **2.18. Guidelines for Liquidity Enhancement Scheme (LES) in Commodity Derivatives Contracts<sup>38</sup>**

2.18.1. The exchanges may introduce liquidity enhancement schemes in commodity derivatives segments subject to the following:

- I. The scheme shall have the prior approval of the Exchange's Board and its implementation and outcome shall be monitored by the Board at quarterly intervals.
- II. The scheme shall be objective, transparent, non-discretionary and nondiscriminatory.
- III. The scheme shall specify the incentives available to the market makers / liquidity providers and such incentives may include discount in fees, adjustment in fees in other segments, cash payment or issue of shares, including options and warrants.

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<sup>38</sup> SEBI circular no [SEBI/HO/CDMRD/DRMP/CIR/P/2018/55](#) dated March 26, 2018



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- IV. The scheme shall not compromise market integrity or risk management.
  - V. The effectiveness of the scheme shall be reviewed by the exchange every six months and the exchange shall submit half-yearly reports to SEBI.
  - VI. The scheme, including any modification therein or its discontinuation, shall be disclosed to the market at least 15 days in advance.
  - VII. Outcome of the scheme (incentives granted and volume achieved – market maker wise and security wise) shall be disseminated monthly.
  - VIII. The scheme shall comply with all the relevant laws.
- 2.18.2. Commodity derivative product eligible for liquidity enhancement schemes - The exchange shall formulate its own benchmarks for selecting the commodity derivative product for liquidity enhancement with the broad objective of enhancing liquidity in illiquid securities.
- I. The exchanges shall introduce liquidity enhancement schemes on any commodity derivative product for a maximum period of three years. Once the scheme is discontinued, the scheme can be re-introduced on the same commodity derivative product provided it is less than the three year period since the introduction of scheme on that security.
  - II. Further, an exchange may introduce liquidity enhancement schemes in commodity derivative product where liquidity enhancement scheme has been introduced in another exchange. Such schemes cannot be continued beyond the period of liquidity enhancement schemes of the initiating exchange.
  - III. The list of commodity derivative product eligible for liquidity enhancement shall be disseminated to the market.
  - IV. Any commodity that is classified as 'Sensitive Commodity' by the Exchange, shall not be eligible for LES.
  - V. If any commodity derivative product is 'liquid' on any of the exchanges i.e. there is at least one exchange where the average daily turnover in Options or/and Futures on similar underlying commodity is more than or equal to INR 200 crore



for agricultural and agri-processed commodity, and INR 1000 crore for non-agricultural commodity during the last six months, then no other exchange is eligible to launch LES on the same derivative product, unless the exchange where the product is liquid, has itself also launched a LES on said product.

- VI. For the present, schemes which incentivise brokers based on activation of new UCC (Unique Client Codes), number of trades or open interest shall not be permissible under LES.
- 2.18.3. The incentives under liquidity enhancement schemes shall be transparent and measurable, and may take either of the following two forms:
  - I. Discount in fees, adjustment in fees in other segments or cash payment - The incentives during a financial year shall not exceed 25% of the net profits or 25% of the free reserves of the exchange, whichever is higher, as per the audited financial statements of the preceding financial year.
  - II. Shares, including options and warrants, of the exchange - The shares that may accrue on exercise of warrants or options, given as incentives under all liquidity enhancement scheme, during a financial year, shall not exceed 25% of the issued and outstanding shares of the stock exchange as on the last day of the preceding financial year. Further, the exchange shall ensure that this is in compliance with the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 at all times.
- 2.18.4. Market integrity - The exchange shall ensure the following:
  - I. Exchanges shall put in place a mechanism to ensure that the LES does not create artificial volumes, does not take away liquidity from the market, is not manipulative in nature and shall not lead to misselling of the product in the market.
  - II. The exchange shall have systems and defined procedures in place to monitor collusion between brokers indulging in trades solely for seeking incentives and prevent payment of incentives in such cases.
  - III. Incentives shall not be provided for the trades where the counterparty is self, i.e., same Unique Client Code (UCC) is on both sides of the transaction.

- IV. Any violations of clauses in this para shall be viewed most seriously.
- 2.18.5. Market maker / liquidity enhancer - The exchange shall prescribe and monitor the obligations of liquidity enhancers (liquidity provider, market-maker, maker-taker or by whatever name called)
- I. All market maker / liquidity enhancer orders / trades should be identifiable by the exchange.
  - II. A conflict of interest framework shall be put in place by the exchange for the liquidity enhancement scheme. Such a framework shall provide for obligation on the part of the market maker / liquidity enhancer to disclose any conflict of interest while participating in the scheme. The same shall be disclosed by the exchange on their website.

#### **2.19. Price Dissemination through SMS/Electronic Communication Facility<sup>39</sup>**

- 2.19.1. Exchanges shall make efforts for registration of subscribers of Price Dissemination services and disseminate derivatives prices to them on a daily basis. Such direct price dissemination service would provide information to subscribers instantly in an efficient and transparent manner and thus shall be of great benefit to market participants.
- 2.19.2. The Exchanges may provide price dissemination through SMS or any other electronic communication facility (instant messengers, email etc.) for all commodities.
- 2.19.3. The service is to be provided free of cost to the subscribers. However, the expenditure incurred for such price dissemination may be reimbursed from the interest accrued on the Investor Protection Fund (IPF).

#### **2.20. Programmes sponsored by the Exchanges through media channels<sup>40</sup>**

- 2.20.1. The Exchanges being neutral platforms, either as an institution or through their functionaries, shall not sponsor or associate

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<sup>39</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/76](#) dated August 30, 2016

<sup>40</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/72](#) dated August 19, 2016

themselves in any manner with programmes/seminars/workshops/activities etc. at various fora including but not limited to TV/Radio/Social Networks/Websites or any other media in which the discussions/suggestions are related to the price behaviour, price outlook, trading strategy, buy/sell recommendations, or similar subjects related to commodity derivatives.

- 2.20.2. Exchanges shall also ensure that the staff members of the Exchanges are not associated with such activities as mentioned above. The Exchanges shall lay down a suitable code of conduct for their executives and other staff members in this regard.

## **2.21. Maintenance and Preservation of Records<sup>41</sup>**

- 2.21.1. In terms of Rules 14 and 15 of SCRR (Securities Contract (Regulation) Rules, 1957), every recognized stock exchange and its members are required to maintain and preserve the specified books of account and documents for a period ranging from two years to five years. Further, as per regulation 18 of Broker Regulations, every stock broker shall preserve the specified books of account and other records for a minimum period of five years. In case such documents are maintained in electronic form, provisions of Information Technology Act, 2000 in this regard shall be complied with.
- 2.21.2. Further, it has been noticed that enforcement agencies like CBI, Police, Crime Branch etc. have been collecting copies of the various records/documents during the course of their investigation. The originals of such documents maintained either in physical or in electronic form or in both would be required by such enforcement agencies during trial of the case also.
- 2.21.3. In view of the above it is clarified that if a copy is taken by such enforcement agency either from physical or electronic record then the respective original is to be maintained till the trial or investigation proceedings have concluded.

## **2.22. Portfolio Management Services in Commodity Derivatives Market<sup>42</sup>**

- 2.22.1. Portfolio management services are not permissible in commodity derivatives Market.

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<sup>41</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/74](#) dated August 30, 2016

<sup>42</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/P/CIR/2016/100](#) dated September 27, 2016

## **2.23. Applicability of Principles of Financial Market Infrastructures (PFMIs) on Commodity Derivatives Exchanges<sup>43</sup>**

- 2.23.1. All CPSS and IOSCO members are required to strive to adopt the PFMIs and implement them in their respective jurisdictions.
- 2.23.2. SEBI as a member of IOSCO is committed to the adoption and implementation of the new CPSS-IOSCO standards of PFMIs in its regulatory functions of oversight, supervision and governance of the key financial market infrastructures under its purview.
- 2.23.3. Currently, all Commodity Derivatives Exchanges themselves are clearing and settling trade executed on their platform, i.e. they are acting as Central Counterparties (CCP) in these markets. Therefore, it has been decided that Commodity Derivatives Exchanges (currently providing in-house clearing services) having annual turnover of more than INR 5 Lac Crore in previous financial year shall be deemed to be systemically important FMs. The criteria may be reviewed by SEBI from time to time.
- 2.23.4. The below-mentioned Commodity Derivatives Exchanges shall be required to comply with the PFMIs specified by CPSS-IOSCO as applicable to CCPs until their clearing and settlement functions are transferred to recognised clearing corporations.
  - I. National Commodity & Derivatives Exchange Ltd. (NCDEX)
  - II. Multi Commodity Exchange of India Ltd (MCX)
- 2.23.5. All FMs in the securities market shall be monitored and assessed against the PFMIs on a periodic basis.

## **2.24. List of Commodities Notified under SCRA<sup>44</sup>**

- 2.24.1. Pursuant to the repeal of the Forward Contracts (Regulation) Act, 1952 (FCRA) and amendment to the Securities Contracts (Regulation) Act, 1956 (SCRA), the Central Government, in exercise of the powers conferred by clause (bc) of section 2 of the SCRA and in consultation with the SEBI, have vide Notification No. S.O. 3068(E) dated September 27, 2016 notified the goods

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<sup>43</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/137](#) dated December 16, 2016

<sup>44</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P 2016/105](#) dated September 28, 2016



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specified therein, for the purpose of clause (bc) of section 2 of the SCRA with effect from the date of the said notification.

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### **Chapter 3. Warehousing Norms for Agriculture and Agri-processed Commodities<sup>45</sup>**

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Warehousing infrastructure and its ancillary services play a critical role in the delivery mechanism of the Commodity Derivatives Market. A robust & credible warehousing infrastructure is sine qua non for an effective Commodity Derivatives Market that can inspire confidence amongst the market participants and other stakeholders. It is therefore, incumbent upon the commodity derivatives exchanges to have in place comprehensive framework of norms for adherence by the Warehouse Service Providers (WSP), warehouse, assayers and other allied service providers engaged by them so as to exercise a robust mechanism, for ensuring good delivery as mandated under the SECC Regulations. The national commodity derivatives exchanges shall frame guidelines in accordance with the following norms for their accredited WSPs, warehouses, assayers etc.

At the outset, it is clarified that the norms prescribed herein are the minimum requirements/standards for compliance by the exchange accredited WSPs, warehouses and assayers and are to be complied with in addition to those laid down by Warehousing Development and Regulatory Authority (WDRA), any other government authority from time to time. The Exchanges are at liberty to prescribe additional norms/guidelines for compliance by their accredited WSPs, warehouses and assayers, if they deem so fit, in addition to the norms laid down hereunder, for ensuring good delivery of commodities by them. Provided that such additional norms specified by the exchanges are not in contravention with the instruction issued herein.

#### **3.1. Accreditation of WSP**

- 3.1.1. The exchanges shall follow a transparent process for accreditation of WSP by issuing open advertisements in leading newspapers and/or putting the same up on the exchange website and through a transparent selection process thereafter. The selection process being/to be followed for such accreditation shall be displayed on the website of the Exchange in advance. The accreditation of the WSP shall be done with the approval of the Risk Management Committee of the Board of Directors of the Exchange. The exchange shall ensure that the application of the WSP/warehouses are processed within a stipulated time frame.
- 3.1.2. A WSP can be accredited with more than one exchange. In such case, no exchange shall mandate that its WSP cannot provide services to another exchange. However, it shall be ensured that same warehouse may not be shared by more than one Exchange.

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<sup>45</sup> SEBI Circular No [SEBI/HO/CDMRD/DMP/CIR/P/2016/103](#) dated September 27, 2016

3.1.3. The accreditation of a WSP shall, unless any expulsion proceedings pending against it, be subject to renewal after a period of **3 years** considering WSP's performance during accreditation, quality of services and number of client complaints and effective resolutions thereof etc.. The renewal shall be approved by the Risk Management Committee of the Exchange. During the renewal process, the Exchange and the WSP shall continue to be responsible for the commodities stored till their Final Expiry date.

### **3.2. Eligibility and Experience of WSP/Promoters/Promoter Group of WSP**

- 3.2.1. A WSP shall be a corporate body and is in public warehousing business.
- 3.2.2. The Promoters/ Promoter Groups of the WSP should be responsible persons/entities of repute with a good business reputation and credibility, and who are in the business of public warehousing for at least 3 years as on the date of their operation and have knowledge of, and experience in, generally accepted warehousing and handling practices for Commodities.
- 3.2.3. The exchange in its discretion, may relax the above norm of 3 years provided that the WSP or its promoter/promoter group:
- I. Meets all other criteria
  - II. Submit an undertaking that they shall meet any additional norm specified by exchanges within the time frame as specified by it or 3 years whichever is earlier
- 3.2.4. WSP and Promoters/ Promoter Group of WSP shall have no record of serious violation of laws or being expelled by any Exchange in last three years. The Exchange can take an appropriate undertaking from the WSP in this regard.

### **3.3. Financial Norms for the WSP**

- 3.3.1. **Capital and Net worth:** A WSP shall be a corporate body with the minimum net worth requirement as under:
- a) An accredited WSP shall have at least, subscribed and paid-up share capital of `10 crore.
  - b) An accredited WSP providing warehousing services shall meet the following net worth criteria:-

Number of commodities	Minimum Networth
1	₹10 crores
More than 1	₹25 crores

- c) Further, the exchanges shall ensure that the value of the goods stored in the accredited warehouses of WSP shall not, at any point of time, exceed 33 times of the net worth of the WSP.
- d) The exchanges may calculate the networth of WSP in the following manner.

*"the aggregate value of paid up equity share capital plus free reserves (excluding statutory funds, benefit funds and reserves created out of revaluation) reduced by the investments in businesses, whether related or unrelated, aggregate value of accumulated losses and deferred expenditure not written off, including miscellaneous expenses not written off."*

- e) In case of reduction in net worth below the stipulated amount, a time period of six month may be allowed to the WSP to augment its net worth. In the event the WSP is unable to augment the net worth to the requisite level within the allowed time frame, the WSP shall not carry out any new business i.e. can not include any new warehouse for new contracts/commodity/location. The exchange may take suitable measures, which are disclosed on its website for public information, with respect to the existing goods handled by such WSP.
- f) The WSP shall submit an audited net worth certificate to the exchange every six months i.e. at the end of every March and September, within 45 calendar days.
- g) The Annual Financial Statements of the WSPs should be audited and submitted to the Exchange within six months of the end of Financial Year. Further, each WSP shall also be required to file its unaudited quarterly financial statements for all the quarters of a financial years to the exchange, within 45 calendar days of the date of a quarterly statement.

- 3.3.2. **Security Deposit:** The WSP seeking accreditation with an exchange is required to furnish a refundable security deposit along with the application form.



- a) Such security deposit shall be a minimum amount of `50 lakhs.
- b) Security deposit shall not be released until six months after cancellation or revocation or surrender of the accreditation of the WSP or until after satisfaction of every claim against the deposit, whichever is later.
- c) Such security deposit shall be in form of cash or cash equivalent like Bank Fixed Deposits, Bank Guarantees etc.

### 3.3.3. Financial Security Deposits (FSD)

- a) The WSP shall furnish FSD in addition to the security deposit as under:-

Value of Goods stored	FSD
Up to ₹250 crores	3% of the aggregate value of stored commodities
Above ₹250 crores and upto- ₹500 crores	4% of the aggregate value of stored commodities
Above ₹500 crores	5% of the aggregate value of stored commodities

- b) The FSD shall be in form of liquid assets with applicable haircuts and concentration limits as listed below:-

Item	Minimum haircut	Limits
Cash	0	No Limit but minimum 25%
Bank Fixed Deposit	0	
Bank Guarantees	0	
Securities of the Central Government	10%	

- c) The exchanges shall lay down exposure limits either in rupee terms or as percentage of the total assets to be received as FSD/SD that can be exposed to a single bank directly or indirectly. The total exposure towards any bank would include Bank Fixed Deposit and Bank Guarantees issued by the bank which have been deposited by WSPs.
- d) Not more than 1% of such assets deposited with the exchange, shall be exposed to any single bank which has a net worth of less than INR 500 crores and is not rated P1 (or P1+) or equivalent, by a recognized credit rating agency or by a reputed foreign credit rating agency, and not more than 10%



of such deposit deposited with the exchanges shall be exposed to all such banks put together.

- e) A daily monitoring of the FSD vis-à-vis the value of the commodities stored needs to be done so as to ensure that the minimum stipulated FSD are always maintained with the Exchange. The exchange may ask for additional FSD over that stipulated above, if considered necessary.
- f) The FSD *vis-a-vis* the value of goods stored should be marked to market on replacement value on ongoing basis.
- g) The exchanges may specify the liquidity ratio (i.e. Liquidity Ratio= Current Assets/Current Liabilities) for WSPs, however it is desirable that such ratio is greater than 1. The Exchanges may, however, keep higher ratio.

### 3.4. Fit and Proper Criteria

- 3.4.1. The exchange shall ensure that the WSP, Promoters of WSP, assayers, Key Management Personnel (KMPs) of WSPs, warehouses and Assayers shall always be 'fit and proper' to carry out business of warehousing, have adequate knowledge of, and experience in generally accepted warehousing and handling practices for Commodities, and are competent and willing to operate such a warehouse for which the WSP has a valid license/expertise under the appropriate state warehousing laws in respect of the warehouses concerned.

### 3.5. Corporate Governance norms for WSP

- 3.5.1. **Management and Employees:** The exchange shall ensure that the accredited WSP has a professional management team to oversee its functioning and operations.
  - I. The exchange shall ensure that the Key Management Personnel (KMPs) of WSP have adequate knowledge of, and experience in generally accepted warehousing and handling practices for Commodities, and are competent and willing to operate such a warehouse, and do not have any conflict of interest in discharge of their functions.
  - II. The exchanges shall ensure that the WSP/Management of WSP (defined as 'key managerial personnel' including whole time directors of WSP and their 'relatives' as per Companies



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Act, 2013) or entities owned or controlled by promoters/management of WSP/Group concerns/associates directly or indirectly or persons ‘acting in concert’ are not allowed, either directly or indirectly, to trade on the commodity derivatives exchange in the commodity for which it is accredited by Exchange. The exchange shall not provide for any exemption in this regard.

- III. The Exchange may obtain an annual declaration from the compliance officer of WSP to the effect that the WSP/Management of WSP or entities owned or controlled by management of WSP/Group concerns directly or indirectly or persons ‘acting in concert’ have not traded on exchange.
  - IV. The exchange shall ensure that the WSP has adequate number of competent employees at all times who have the experience, capacity and ability of operating the business without any conflict of interest.
  - V. The exchange shall ensure that the staff/employees of the WSP including the assayers, who are managing the day-to-day affairs of the warehouses, deployed both in the office of the WSP and in its warehouses, are duly trained on their expected tasks through the Exchange’s delivery business related training programmes or are deputed to attend the certification programme on commodity derivatives and warehousing conducted by National Institute of Securities market (NISM).
- 3.5.2. **Compliance officer:** The WSP shall appoint a compliance officer who shall be responsible for monitoring the compliance with relevant Act, rules and regulations, notifications, guidelines and instructions issued by relevant authorities from time to time. The Compliance officer of the WSP shall ensure that all norms mentioned are followed by the WSP and should issue a declaration to that effect to the Exchange, at regular intervals as directed by the exchange.
- 3.5.3. **Standard Operating Procedure (SOP):** The WSP shall have a SOP and the exchange shall obtain a standard operating procedure in respect of all the concerned warehouses from the WSP before granting accreditation to such warehouses. The SOP of a warehouse may cover the following but not restricted to:
- I. Procedures for acceptance of goods to be deposited
  - II. Weigh bridge empanelment

- III. Procedures for weighing, sampling of goods to be deposited as per industry standards, Procedure for verification of commodity and communication to depositors,
  - IV. Procedure for depositing and identifying the Exchange related goods,
  - V. Procedure for maintaining the quality of the goods stored as per the exchange contract specification,
  - VI. Procedure for Know your depositor requirements,
  - VII. g) Security policy for ensuring the safety of the goods from theft, burglary etc.,
  - VIII. Procedure and guidelines for scientific storage of goods, including stacking etc.
  - IX. Procedure for losses caused due to theft, fire, burglary, fraud, negligence and force majeure events,
  - X. Procedure for internal verification of stock,
  - XI. Preservations of Stock – maintenance of godown hygiene, maintenance of warehouse structure, aeration, periodical examination of goods, classification of presence of insects, pre-monsoon precautions etc.
  - XII. Selection of Location for offering warehousing services
  - XIII. Grievance redressal procedures
  - XIV. Role and responsibilities of employees (including outsourced employees)
  - XV. Model warehouse agreement format
  - XVI. Maintenance of surroundings, infrastructure etc.
- 3.5.4. The WSP shall have good internal systems and controls which should meet the operating guidelines, if any, issued by the Exchange from time to time. The WSP shall have clear delegation of powers to meet operational requirement.
- 3.5.5. A WSP shall intimate /notify in writing to the Exchange, if there is any material change, prior to making such change.
- 3.5.6. WSP shall report to the Exchange within three business days of initiation of any civil and criminal proceedings by or against it and shall also intimate the exchange if there is probability of any such legal proceedings being initiated involving it ,as soon as the same comes to the knowledge of the WSP.

### **3.6. Know Your Depositor**

- 3.6.1. The WSP shall comply with Know Your Depositor (KYD) Policy as prescribed by the Exchange from time to time.

- 3.6.2. The Exchange and WSP shall at any point of time be able to identify the depositor of the goods deposited in registered warehouses, the owner of the deposited goods (in case the depositor is an agent of the actual owner), and also the actual beneficiary (in case the depositor and the beneficiary are different) of the deposited/stored commodities.

### **3.7. PAN requirement**

- 3.7.1. The exchanges shall ensure that the WSPs are under obligation to provide to the exchanges the details including PAN numbers of its Promoters, Promoter group entities, its holding / subsidiaries / associates and other related entities, persons ‘acting in concert’, Key Management Personnel at the time of accreditation and update the same on periodical basis as mandated by the exchanges and whenever any change is noted by WSP, in this regard.

### **3.8. Facilities & Infrastructure Requirement for WSP**

The Exchanges shall ensure that the WSPs to be eligible for accreditation have reasonable facility and infrastructure for proper handling and storage of commodity such as:

- 3.8.1. All its warehouses are well connected with rail and/or road networks and have sufficient space for parking and movement of large vehicle;
- 3.8.2. The warehouses are physically and operationally suitable for the proper storage of Commodities and:
- I. are of sound construction and in a state of good repair. The walls, the floor and the roof do not permit water seepage or are source of any insect infestation;
  - II. have adequate equipment, installed and maintained in good working order, as may be prescribed by the Exchange, for the movement of commodities into, out of and within the warehouse. Further, the employees employed at the warehouses shall undergo training in fire safety and use of firefighting equipments;
  - III. have adequate firefighting equipment installed within its premises and have fire escapes and fire hydrant points clearly marked;



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- IV. have required ventilation, installed and maintained in good working order, as may be prescribed by the Exchange, for the proper storage and preservation of quality of goods;
  - V. have adequate lighting arrangement as may be prescribed by the Exchange;
  - VI. are free from materials and substances that may adversely affect the quality of stored commodities;
  - VII. have a safe work environment;
  - VIII. have ensured adequate security as prescribed by the Exchange for protection of stored or handled commodities to prevent from tampering or adulteration;
  - IX. have facilities for storing the deliverable commodities of futures contracts which need to be and piled properly in a separate storage area as specified by the Exchange thereby providing clear-cut demarcation between Exchange / non- Exchange commodities.
- 3.8.3. WSP shall take utmost care in storing commodities for futures contract in accordance with the climatic conditions and the nature of commodity stored.
- 3.8.4. WSP shall have adequate security personnel for each of its registered warehouse with required facilities to immediately communicate any unlawful entry, burglary, theft or damage or potential loss to the deposited goods to the WSP.
- 3.8.5. Each warehouse of an accredited WSP shall assign a special place to store the samples used for inspection and testing for purpose of further examination and testing.
- 3.8.6. WSPs shall take utmost care on daily basis for keeping surroundings for their respective warehouses under vegetation control and for disposal of waste which can otherwise create a favourable habitat for rodents and other pests. WSP should regularly inspect and verify whether rodent control structures in the warehouse are sound and whether there are any pools of water around the facility, which can increase the danger of water seepage into it, and take appropriate remedial steps.
- 3.8.7. The exchanges shall ensure that the warehouses provided by the WSPs are under absolute control of the WSPs. In case a warehouse is a leased property it should be ensured that no third party including the owner/ lessor of the warehouse, has any role to play in the operations and managing the concerned warehouses operated by the WSP.

- 3.8.8. The exchanges shall develop the SOP with respect to the maintenance, preservation and retrieval of data/records/books of accounts which shall be uniformly adopted by each of their accredited WSP/warehouse.
- 3.8.9. WSP shall always give priority to commodities meant for futures contracts delivery while receiving, storing and dispatching goods. It should have internal process that enable the Exchange to physically verify by deputing its officials or through any agencies / experts engaged by it, the goods deposited, the facilities available in such warehouse, or to inspect the level of compliance g of the warehousing norms stipulated by the exchange/regulator from time to time.
- 3.8.10. The WSP shall undertake to have assaying/testing facilities for the commodities it intends to render warehousing facility, or shall undertake to be associated with an assaying/testing agency which may preferably be certified by one or more national/international agencies like NABL (National Accreditation Board for calibration and testing Laboratories), BIS etc., as specified by the exchange.
- 3.8.11. The WSP shall provide for accurate and efficient weighing, sampling, inspection and grading of the Commodities deposited in its warehouses. The Exchange shall ensure that the WSP has deployed personnel who have knowledge and experience in sampling, weighing, inspecting and/or grading of commodities.
- 3.8.12. The WSP shall have its own or access to fumigation facilities/agencies for pest control activities.
- 3.8.13. Exchanges shall ensure that the WSPs have in place, necessary policies, control and system in place for dealing with the risk that may be arising due to the warehouses being used for purposes other than commodity derivatives market.
- 3.8.14. The exchange and WSP shall be responsible to accept the goods/commodities in warehouses which meets the quantity and quality parameters as per the exchange contract specifications. The WSP shall take necessary steps to maintain the quality and quantity of goods stored in the warehouse, in accordance with the conditions/parameters (for maintaining the quality) as laid down by the exchanges for each of such commodity.
- 3.8.15. The WSP shall display on a daily basis warehouse wise/commodity wise details of the space available, goods deposited and held in transit, details of location of the warehouse, particulars of rejection

of the goods etc. on its website and the archives of such reports shall be available on its website.

- 3.8.16. The WSP shall not disseminate any information that is false or misleading or disclose any confidential information obtained during the course of their dealings with the exchanges or their positions on the market or as a result of their position or during the course of performance of their duties.

### **3.9. Accreditation of Assayers**

- 3.9.1. The exchanges shall follow a transparent process for accreditation of assayers by issue of open advertisement in leading newspapers and by putting up the same on the exchange website. The process being followed for such accreditation shall be displayed on the website of the Exchange in advance. The accreditation shall be done with the approval of the Risk Management Committee of the Board of Directors of the Exchange.
- 3.9.2. The Exchange shall conduct independent pre-empanelment due diligence of Assayers by visiting the laboratories and assessing the testing and certification facilities. The exchanges shall give preference to the government assayers or to those Assayers who are having testing and certification facilities at various locations across India. In addition to the empanelment of assayers for deployment by the WSPs at their warehouses, the exchange shall also identify and empanel separate independent assayer(s) at each such delivery location where the market participants can independently get their goods/commodities assayed, at the time of depositing into or withdrawing such commodities/goods from a warehouse. However, if the original empanelled assayers engaged by WSP at a delivery centre happened to be Government assayer, then the need for empanelling an additional independent assayer may be dispensed with.
- 3.9.3. The exchanges shall ensure that the empanelled assayers work independently and their operations are governed by prescribed Standard Operating Procedures (SOPs). The assayers shall be preferably certified by one or more national/international agencies like NABL (National Accreditation Board for calibration and testing Laboratories), BIS etc., and shall have the facilities as laid down by the exchanges from time to time.

### **3.10.Warehouses at delivery centres**

- 3.10.1. The exchanges shall ensure that all the warehouses of a WSP accredited by them are registered with the statutory authority viz., WDRA. The exchanges shall take necessary steps to ensure that warehouses which are not registered with the WDRA are registered by WDRA within 6 months from the date of such accreditation, failing which the accreditation given to the WSP in respect of such warehouses shall expire.
- 3.10.2. The exchanges shall have at least one warehouse at each of the delivery centres (as specified in the contract specification) at the time of launch of contract itself and address of such warehouses shall be mentioned in the contract specifications.
- 3.10.3. The exchanges may accredit warehouses of a WSP within 100 kms radius of the delivery centres depending on the feasibility and requirements, in respect of all commodities.

### **3.11.Insurance**

- 3.11.1. The WSP shall at all times ensure to fully cover under insurance, the value of goods stored at exchange approved warehouses against all potential perils relevant to the commodities for which insurance cover is available and necessary.
- 3.11.2. The WSP shall undertake to take insurance cover for risks such as viz. Fire and allied perils including flood, cyclone, earthquake and spontaneous combustion, Burglary and Theft and special perils covering riots, strikes and terrorism.
- 3.11.3. The WSP shall take Fidelity guarantee & crime insurance and Professional indemnity cover to cover all deliverable stocks on the exchange.
- 3.11.4. The value of goods to be insured should be marked to market on replacement value on ongoing basis.

### **3.12.Monitoring/Inspection/Audit of warehouses by WSPs and Exchanges**

- 3.12.1. **Periodic inspection/audit by WSPs:** The WSP should ensure that there is periodic inspection/audit of the warehouse as well as the commodities stored in the warehouses.
  - I. Inspection staff must be independent of the employees / staff deputed at the registered warehouse.



- II. The inspection/audit report is submitted to the Exchange within a week of the completion of such inspection/audit.
  - III. The Exchange shall ensure that the physical counting of stocks and their reconciliation with the corresponding electronic records is done periodically.
- 3.12.2. The WSP shall allow the members /clients holding electronic credit balances to do physical inspection of their goods. However, the request for such physical inspection would have to be submitted to the Exchange and the Exchange after verification of such request, shall forward the same to the concerned WSP for allowing such inspection within a stipulated time.
- 3.12.3. **Periodic inspection/audit of warehouses by the exchange:** The Exchange shall ensure that independent audit of the stocks and other facilities in the warehouses is carried out by engaging expert agencies, at regular intervals.
- I. Such inspections shall be carried out at least twice in each accredited warehouse in a calendar year with a gap of not more than six months between two inspections/audits of same warehouse.
  - II. In addition to the above, the audit may also be conducted on risk profiling, as identified by the Exchange. For this purpose, the Exchange shall form a panel of independent expert agencies and the cost of such audit shall be borne by the respective Exchange.
  - III. The result of such audit/audit report shall be displayed by the Exchange on its website immediately after the completion of the audit and submission of report by the auditor.
  - IV. The exchanges shall prepare a panel of such independent expert agencies for carrying out inspection of warehouses, which shall also be reviewed by the Exchange from time to time. In addition, the Exchanges shall also conduct in-house physical audit of accredited warehouses at regular intervals.
  - V. Exchange should also carry out surprise inspections of warehouses as and when such exigencies arise in terms of the prescribed norms.
  - VI. The exchange shall have a policy of rotation of such independent expert agencies for carrying out inspection after every 3 years with a provision for 'cooling off' period of 1 year.

VII. The exchange shall have a detailed inspection manual for carrying out the audits and inspections of the WSP/warehouses concerned.

**3.12.4. Monitoring of warehouses by exchange:** The exchanges shall be responsible for the monitoring of the warehouses of their accredited WSPs. In this regard:

- I. Norms relating to the monitoring of warehouses shall be placed in public domain.
- II. A deliberation on the continuous functioning, monitoring and compliance of norms by WSPs, warehouse and assayers shall be a mandatory agenda item in all Board meetings as well as the Risk management committee meeting of the exchange.
- III. The Exchange and WSPs shall ensure that the goods whose final expiry date is over, are removed from the concerned warehouse immediately, but not later than 3 months from the date of the final expiry date.

### **3.13. Review of WSPs/Warehouses**

**3.13.1.** The Exchange shall review and appraise operational performance of each WSP every year. Based on the operational review the Exchange may adjust the allocation of commodities and the limit of deliveries at various warehouses of the concerned WSP in accordance with the results of such performance evaluation and appraisal.

**3.13.2.** Additionally, the Exchange may carry out biennial and quarterly performance review of all warehouses accredited by it, taking into account various performance areas such as storage facilities, the capacity and appearance of the warehouse, business capabilities, business performance, accounting, the satisfaction level of members/clients, redressal of client grievances, and other factors as the Exchange may deem necessary for its review.

**3.13.3.** The exchange may take necessary action against as mentioned in para S against a WSP/warehouse, if the warehouse is unable to meet the requirements of an accredited warehouse and fails to improve the standard within the stipulated time.

### **3.14.Code of Conduct**

- 3.14.1. The exchange shall frame necessary code of conduct for the WSPs, warehouses and assayers.
- 3.14.2. The said code of conduct shall be displayed on the exchange website.

### **3.15.Grievance Cell**

- 3.15.1. The exchange shall ensure that it has a Grievance Cell to handle consumer complaints.
- 3.15.2. The exchange shall take proactive steps to resolve customer related issues and maintain a record of complaints received / resolved.
- 3.15.3. The exchange shall require the WSP to report the details of complaints received / resolved by it/ pending and action taken on the complaints, once in every fortnight.

### **3.16.MIS System**

- 3.16.1. WSP shall have a Standard Operating Procedure (SOP) which is process-dependent and not person-dependent. It is desirable that there should be electronic record of information at the WSP and a MIS system with an arrangement for flow of real time information from the warehouse location to the central MIS and onwards to Exchange electronically. The MIS should have the capability to capture and disseminate information regarding stocks being held warehouse wise/location wise, and the availability of space in the warehouses.
- 3.16.2. The exchange shall display on a daily basis warehouse wise details of the space available, stock of goods held, name of the warehouse service provider, details of location of the warehouse, particulars of acceptance/rejection of goods by the warehouse concerned, details of empanelled assayers and independent assayers, if any, attached to the warehouse etc., on its website. The archives of such reports shall be available on the exchange website.
- 3.16.3. The participants/clients willing to deposit goods in Exchange accredited Warehouses would submit a request to the Exchange. The Exchange shall use a transparent and time-bound process for the participants to identify the warehouse where the participants can deposit the goods. After such identification, the Exchange shall

intimate the participants about the time, place and the warehouse where they can deposit the goods. The Exchange shall then issue directions to the concerned warehouse for accepting deposits from the concerned participants/clients after assaying/ quality testing as per the laid down procedure in a transparent manner. The WSP shall accept the goods for deposits only at the instruction of Exchange concerned.

### **3.17. Surrender/Cancellation of accreditation**

- 3.17.1. Any WSP that applies for surrender of its accreditation shall submit its Application for Surrender to the Exchange for evaluation and approval.
- 3.17.2. The exchange may cancel the accreditations a WSP if it fails to comply with the provisions of the rules/regulations specified by it and intimate the same to the market participants through circular. Further, the exchange shall put in place a cancellation policy for WSP in public domain. However, the exchange shall offer the WSP concerned an opportunity of being heard and take a decision on cancellation after considering the explanation of the WSP.
- 3.17.3. A WSP that surrenders its accreditation or its accreditation is cancelled, shall attend to the following matters urgently:
  - I. All commodities for futures contract delivery shall be dispatched out of the warehouse or converted to physical commodities;
  - II. All liabilities and debts vis-a-vis the Exchange , Member and Clients shall be settled;
  - III. There is no obligation on its part to deliver goods to the clients pertaining to their trades on the exchange platform, and
  - IV. No customer complaints pertaining to any of its registered warehouses are pending for redressal.
- 3.17.4. SD and FSD shall be returned in accordance with the Exchange's rules, keeping aside 10% of such deposits with the exchange, which shall not be released until six months after cancellation or surrender of accreditation of the WSP or until satisfaction of all claims against the deposits made in its warehouses, whichever is later.
- 3.17.5. A WSP which surrenders its accreditation with the exchange shall not be eligible to provide its services to the exchange for a period of 3 years.

- 3.17.6. Once the accreditation of a WSP is cancelled or WSP is expelled by an exchange then it shall not be eligible to provide its services to any commodity derivatives exchanges for 3 years.
- 3.17.7. Adequate notice intimation to general public / clients should be given through widely published newspapers and website etc. before accepting the surrender of WSP or cancellation/expulsion of the WSP.

### **3.18. Business Continuity Plan**

- 3.18.1. A WSP shall put in place, a business continuity plan and submit such plan to the exchanges.

### **3.19. Actions against WSPs**

- 3.19.1. The Exchange may frame byelaws/rules/regulations/guidelines for its accredited WSPs to rectify correct their misconduct or misconduct on the part of any of its approved warehouses used for storing goods for delivery on exchange platform. The exchanges may also direct the WSPs to indemnify an entity aggrieved by the delivery process of its warehouse or, in serious cases of misconduct/malfeasance, revoke the accreditation of the concerned warehouse or/and hold the WSP accountable for any legal liabilities, if the concerned erring WSP/ warehouse engages in any of the following offences:

- I. refuses to accept delivery without any bonafide reasons or, issues a falsified certificate of delivery;
- II. violates any of the Exchange's rules or limits the movement of a deliverable commodity into or out of the warehouse;
- III. discloses any confidential business information relating to a buyer or seller or a futures contract;
- IV. provide inaccurate or incomplete information, conceal the truth of the facts;
- V. engages in the futures trading activities; or
- VI. engages in any other behaviour in breach of the Exchange's rules; or
- VII. any other offence not listed above.

However, the above actions may be initiated only after taking due approval from the Risk management Committee.

- 3.19.2. The accredited WSP shall be liable for any losses resulting from any action or inaction on its part or on the part of its warehouses

that prevents the buyer or seller from exercising, in whole or in part, their rights. The Exchange shall compensate the aggrieved client for any such losses that have been appropriately established by debiting the FSD of WSP held with the exchange, in accordance with its applicable rules, and WSP shall within 7 days replenish the FSD as required.

### **3.20.Cold Storages**

3.20.1. In case of any commodity which generally require storage in the cold storages, the exchanges shall ensure that such commodities are stored in cold storages only.

### **3.21.Status report**

3.21.1. The Exchanges shall upload a status report on their websites by 5<sup>th</sup> of every month giving the details of the number of applications received for accreditation of warehouses, Warehouses registered with WDRA during the month, registration pending with WDRA, warehouses pending with Inspecting Agencies, accreditation/registration of warehouses rejected by Exchange/WDRA with reason for the same, etc.

3.21.2. The archives of such reports shall be available on the exchange website.

The exchanges shall put in place necessary arrangements for ensuring compliance with the provisions of the Regulation 44D(2) of SECC Regulations regarding guarantee for settlement of trades including good delivery. Further, the exchanges have necessary arrangements to ensure that in the event of bankruptcy or insolvency of the WSP or other such contingency, there must be no restrictions placed upon owners/depositors of the commodity wishing to take possession of their individually identified commodity and remove it from the accredited Warehouse(s).



## Chapter 4. Risk Management

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### 4.1. Comprehensive Risk Management Framework for National Commodity Derivatives Exchanges<sup>46</sup>

#### 4.1.1. Overview

The core of the risk management system of national commodity derivatives exchanges (Exchanges) shall comprise of the following:

- I. **Liquid Assets:** Liquid assets shall be deposited by members with the Exchanges in compliance with the norms specified herewith to cover various margin and deposit requirements.
  - II. **Initial Margins (IM)<sup>47</sup>:** Margins to cover potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default subject to minimum percentage floor value as prescribed by SEBI from time to time.
  - III. **Extreme Loss Margins (ELM):** Margins to cover the loss in situations that lie outside the coverage of the VaR based initial margins.
  - IV. **Additional Margins:** Margins imposed on both long and short sides over and above the other margins, would be called additional margins.
- Tender Period Margin/Pre-expiry Margin:** Exchanges shall levy tender period /pre-expiry margin which may be increased gradually every day beginning from the pre-determined number of days before the expiry of the contract as applicable.
- V. **Delivery Period Margin:** Appropriate delivery period margin shall be levied by Exchanges on the long and short positions marked for delivery till the pay-in is completed by the member. Once delivery period margin is levied, all other applicable margins may be released.
  - VI. **Minimum Liquid Net-worth Requirement:** Initial margins, ELM, additional margins or any other margins as may be specified by SEBI from time to time shall be deducted from the liquid assets of a clearing member. The clearing member's liquid

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<sup>46</sup> SEBI Circular No. [CIR/CDMRD/DRMP/01/2015](#) dated 01 Oct 2015

<sup>47</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/77](#) dated September 01, 2016

assets after adjusting for applicable margins shall be referred to as 'Liquid Net-worth' of the clearing member. Clearing Members shall maintain 'Liquid Net-worth' as specified by SEBI from time to time.

- VII. **MTM (Mark to Market) Settlement:** Mark to market settlement of all open positions of clients/members shall be done on daily basis.
- VIII. **Base Minimum Capital:** Exposure free deposit required from all members of exchanges.
- IX. **Settlement Guarantee Fund (SGF):** Exchanges shall maintain SGF which shall be used by Exchanges only for the purpose of providing settlement guarantee.
- X. **Concentration margins:** Margins to cover the risk of longer period required for liquidation of concentrated positions in any commodity derivatives contract.

#### 4.1.2. Liquid Assets

The types of liquid assets acceptable by Exchanges from their members and the applicable haircuts and concentration limits are listed below:

Item	Minimum Haircut (see Note 'a')	Limits
<b>Cash Equivalents</b>		
Cash	0	No limit
Bank fixed deposits	0	No limit (see Note i) <sup>48</sup>
Bank guarantees	0	Limit on exchange's exposure to a single bank (see Note 'b')
Securities of the Central Government	10%	No limit
Units of liquid mutual funds or government securities mutual funds (by whatever name called which invest in government securities)	10%	No limit
<b>Other Liquid Assets</b>		

<sup>48</sup> SEBI Circular [SEBI/HO/CDMRD/DRMP/CIR/P/2018/52](#) dated March 21, 2018

Item	Minimum Haircut (see Note 'a')	Limits
Liquid (Group-I) Equity Shares (see Note 'd')	Same as the VaR margin for the respective shares (see note 'd')	Limit on exchange's exposure to a single issuer (see Note 'e')
Mutual fund units other than those listed under cash equivalents	Same as the VaR margin for the units computed using the traded price on stock exchange, if available, or else, using the NAV of the unit treating it as a liquid security (as per methodology given in para (ii) of Annexure J.).	
Corporate Bonds having rating of AA or above( or with similar rating nomenclature) by recognised credit rating agencies	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%	Not to exceed 10% of the total liquid assets of the clearing member. (see Note 'e')
Bullion	20%	Total commodities collateral for any clearing member shall not exceed 30% of the total liquid assets of the clearing member, out of which non-bullion collateral shall not exceed 15% of the total liquid assets of the clearing member <sup>49</sup> (see note 'f')
Gold ETF	20%	
Steel	60%	
Agricultural Commodities	40%	

**Notes:**

- a. The valuation of the liquid assets shall be done on a daily basis after applying applicable haircuts.

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<sup>49</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/112](http://SEBI/HO/CDMRD/DRMP/CIR/P/2016/112) dated 14 October 2016



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- b. The exchanges shall lay down exposure limits either in rupee terms or as percentage of the total Liquid Assets that can be exposed to a single bank directly or indirectly. The total exposure towards any bank would include Bank Guarantees issued by the bank as well as debt or equity securities of the bank which have been deposited by members towards total liquid assets.

Not more than 1% of the total liquid assets deposited with the exchange, shall be exposed to any single bank which has a net worth of less than INR 500 crores and is not rated P1 (or P1+) or equivalent, by a recognized credit rating agency or by a reputed foreign credit rating agency, and not more than 10% of the total liquid assets deposited with the exchange shall be exposed to all such banks put together.

- c. 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 member's liquid assets as well as total liquid assets.
- d. For determination of which equity shares are falling in Group-I and what would be the appropriate VaR margin for these securities, data disseminated by Stock Exchanges having equity platform shall be referred. Stock Exchanges are already required to compute the same on regular basis in accordance with **Annexure J**.
- e. Exchanges shall adequately diversify their collateral so as to avoid any concentration of exposure towards any single entity and the same shall be within the limits as may be prescribed by SEBI from time to time.
- f. Agricultural commodities to be accepted as collateral should be of same quality specification which is deliverable under the contract specification of agricultural commodities derivatives being traded on the Exchange.
- g. Exchanges shall accept liquid assets as collateral only as per the list of liquid assets specified in the table above. However, exchanges may decide not to accept certain types of liquid assets specified in the above list based on their risk perception, capability to hold and arrangements for timely liquidation. Exchanges may stipulate concentration limits at member level / across all members as may be necessary.
- h. Exchanges shall make necessary arrangements to enable timely liquidation of collaterals accepted by them.
- i. <sup>50</sup>Commodity Derivatives Exchanges shall not accept Fixed Deposit Receipts (FDRs) from trading/clearing members as collateral, which are issued by the trading/clearing member themselves or banks who are associate of trading/ clearing member.

Explanation –for this purpose, 'associate' shall have the same meaning as defined under Regulation 2 (b) of SECC Regulations2012.

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<sup>50</sup>SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2018/52](#) dated 21 March 2018

#### 4.1.3. Commodity Futures

##### I. Initial Margins (IM)<sup>51</sup>

Exchanges shall impose initial margins sufficient to cover its potential future exposure to participants in the interval between the last margin collection and the close out of positions following a participant default. Exchanges shall therefore estimate appropriate Margin Period of Risk (MPOR) for each product based on liquidity in the product. However, the MPOR for all commodity derivatives contracts shall be at least 2 days.

- A. **Minimum value for Initial Margin:** Minimum value of initial margin would be subject to commodity specific floor value as may be specified by SEBI from time to time. Currently floor value of IM applicable for Nickel shall be 5% and for all other commodities it shall be 4%.
- B. **Margin Computation at client portfolio level:** Margins shall be computed at the level of portfolio of each individual client comprising his positions in futures contracts across different maturities. For Trading/Clearing Member level margins computation, margins would be grossed across various clients. The proprietary positions of the Trading Member would also be treated as that of a client for margin computation.
- C. **Spread margin benefit: –**
  - i. Spread benefit in initial margin shall be permitted in the following cases:
    - a) Different expiry date contracts of the same underlying
    - b) Two contracts variants having the same underlying commodity
    - c) Futures contracts in a commodity complex provided the conditions in **para ii** below are met<sup>52</sup>.
  - ii. Exchanges may provide spread benefit in initial margin across futures contracts in a commodity complex provided the following conditions are met:
    - a) Minimum coefficient of correlation ( $r$ ) between futures prices of the two commodities is 0.90.

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<sup>51</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/77](#) dated 01 Sep 2016

<sup>52</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2018/51](#) dated 20 March 2018



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- b) Back testing for adequacy of spread margin to cover MTM has been carried out for a minimum period of one year (back testing for at least 250 days wherein daily settlement price of futures used for back testing have been determined from **traded futures prices**).
- c) Initial margin after spread benefit has been able to cover MTM on at least 99% of the days as per back testing.
- iii. Maximum benefit in initial margin on spread positions indicated in para [i – (a) and (b)] is restricted to 75%. Maximum benefit in initial margin on spread positions indicated in para [i – (c)] is restricted to 50%.
- iv. In case of spread positions additional margins shall not be levied. No benefit in ELM would be provided for spread positions i.e. ELM shall be charged on both individual legs. Exchanges are free to charge margins higher than the minimum specified depending upon their risk perception.
- v. <sup>53</sup>Margin benefit on spread positions shall be entirely withdrawn latest by the start of tender period or start of expiry day, whichever is earlier.
- vi. To be eligible for initial margin benefit, each individual contract in the spread shall be from amongst the first three expiring contracts.
- vii. <sup>54</sup>While providing spread benefit across futures contracts in a commodity complex, exchanges shall continuously monitor dynamics of the commodities and their correlation and if there are changes such that spread margin benefit is no longer appropriate to be given, shall take appropriate further course of action.

**D. Real Time Computation:** The margins should be computed on real time basis. The computation of portfolio initial margin would have two components. The first is the computation of initial margin for each individual contract. At the second stage, these contract initial margins would be applied to the actual portfolio positions to compute the portfolio initial margin. The exchanges are permitted to update EWMA volatility estimates for contracts at discrete time points each day (with a gap of

<sup>53</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/130](#) dated 02 December 2016

<sup>54</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2018/51](#) dated 20 March 2018



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not more than 2 hours between any two consecutive updates and at the end of the trading session) and the latest available scaled up WMA volatility estimates would be applied to member/client portfolios on a real time basis.

- II. **Extreme Loss Margin (ELM):** ELM of 1% on gross open positions shall be levied and shall be deducted from the liquid assets of the clearing member on an online, real time basis.
- III. **Additional Margins:** Exchanges may levy Additional Margins based on their evaluation in specific situations as may be necessary.
- IV. **Tender Period Margin:** Exchanges shall levy Tender period/Pre-expiry margin which shall be increased gradually every day beginning from the pre-determined number of days before the expiry of the contract as applicable. Exchanges shall determine the quantum of tender period margin as appropriate based on the risk characteristics of the particular commodity.
- V. **Delivery Period Margin<sup>55</sup>:** Appropriate delivery period margin shall be levied by Exchanges on the long and short positions marked for delivery till the pay-in is completed by the member. Once delivery period margin is levied, all other applicable margins may be released.

However, delivery period margins shall be higher of:

- A. 3% + 5 day 99% VaR of spot price volatility  
Or
- B. 20%  
Or
- C. Applicable delivery period margins as on September 01, 2016

Exchanges may impose higher margins if deemed fit.

- VI. **Mark to Market (MTM) Settlement:** All open positions of a futures contract would be settled daily, only in cash, based on the Daily Settlement Price (DSP). DSP shall be reckoned and disseminated by the Exchange at the end of every trading day. The mark to market gains and losses shall be settled in cash before the start of trading on T+1 day. If mark to market obligations are not collected before start of the next day's trading, the exchange shall collect correspondingly higher initial margin (scaling up by a factor of square root of two) to cover the

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<sup>55</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/77](http://SEBI/HO/CDMRD/DRMP/CIR/P/2016/77) dated 01 September 2016



potential losses over the time elapsed in the collection of margins.

#### 4.1.4. Options on commodity futures<sup>56</sup>

Exchanges shall adopt risk management framework compliant with the CPMI-IOSCO Principles for Financial Market Infrastructures, including the following:

**I. Margining model and quantum of initial margins:**

Exchanges shall adopt initial margin models and parameters that are risk-based and generate margin requirements sufficient to cover potential future exposure to participants/clients in the interval between the last margin collection and the close out of positions following a participant/client default. The model should :

- A. use a conservative estimate of the time horizons for close out of the positions (including in stressed market conditions),
- B. have an appropriate method for measuring credit exposure that accounts for relevant risk factors and portfolio effects, and
- C. to the extent practicable and prudent, limit the need for destabilizing, pro-cyclical changes.

Initial margin requirement shall be adequate to cover 99% VaR (Value at Risk) and Margin Period of Risk (MPOR) shall be at least two days. In case of portfolio based margining, this requirement applies to each portfolio's distribution of future exposure.

Accordingly, exchanges shall fix prudent price scan range, volatility scan range and/or plausible changes in any other parameters impacting options price. Exchange shall impose appropriate short option minimum margin, calendar spread charge and extreme loss margin for option contracts.

**II. Margining at client level:** Exchanges shall impose initial margins at the level of portfolio of individual client comprising of his positions in futures and options contracts on each commodity.

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<sup>56</sup> SEBI Circular No. [SEBI/HO/CDMRD/DMP/CIR/P/2017/55](http://SEBI/HO/CDMRD/DMP/CIR/P/2017/55) dated 13 June 2017



- III. Real time computation:** Though the margining models may update various scenarios of parameter changes (underlying price, volatility etc.) at discrete time points each day (at least every two hours), the latest Page 4 of 4 available scenarios shall be applied to client portfolios on a real time basis.
- IV. Mark to market:** Exchanges shall mark to market the options positions by deducting/adding the current market value of options (positive for long options and negative for short options) times the number of long/short options in the portfolio from/to the margin requirement. Thus, mark to market gains and losses would not be settled in cash for options positions.
- V. Risks pertaining to options that devolve into futures on expiry:**
  - A. For handling increase in margins on expiry when options devolve into futures position, specifically for long option positions which are probable to be exercised, exchanges shall start sensitizing the option holders of the impending increase in margins (along with the estimated increase) at least few days in advance, and/or, based on their risk perception, may also consider gradually collecting increased margins during the last few days so as to have adequate margins to cover the risk of futures position that will be created on devolvement of options into futures.
  - B. As per the provisions given in [4.1.14 below](#), penalty is levied on members for short-collection/non-collection of the initial margins. Penalty for such short-collection/non-collection due to increase in initial margins resulting from devolvement of options into futures may not be levied by Exchanges for the first day.

#### 4.1.5. Concentration Margins<sup>57</sup>

Exchanges shall impose adequate concentration margins (only on concentrated positions) to cover the risk of longer period required for liquidation of concentrated positions in any commodity. The threshold value for imposing concentration margin may be determined taking into account factors including open interest, concentration and estimated time to liquidation based on prevailing liquidity and possible reduction

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<sup>57</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/77](#) dated 01 September 2016

in liquidity in times of market stress etc. The quantum of concentration margins imposed may vary based on the level of concentration.

#### 4.1.6. Additional Ad-hoc Margins

Exchanges have the right to impose additional risk containment measures over and above the risk containment system mandated by SEBI. However, the Exchanges should keep the following three factors in mind while taking such action:

- A. 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. Exchanges are encouraged to analyse these situations and bring the matter to the attention of SEBI for further action.
- B. 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.
- C. Transparency is an important regulatory goal and therefore every effort must be made to make the risk management systems fully transparent by disclosing their details to the public.

#### 4.1.7. Margin Provisions for Intra-day crystallized losses:<sup>58</sup>

To mitigate the risk arising out of accumulation of crystallized obligations incurred on account of intra-day squaring off of positions, the following has been decided:

- A. The intra-day crystallized losses shall be monitored and blocked by Clearing Corporations from the free collateral on a real-time basis only for those transactions which are subject to upfront margining. For this purpose, crystallised losses can be offset against crystallised profits at a client level, if any.

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<sup>58</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2018/52](#) dated 21 March 2018



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- B. If crystallised losses exceed the free collateral available with the Clearing Corporation, risk reduction mode shall be followed.
- C. Crystallised losses shall be calculated based on weighted average prices of trades executed.
- D. Adjustment of intraday crystallised losses shall not be done from exposure free liquid networth of the clearing member.

### 4.1.8. Margin Collection and Enforcement

All applicable margins shall be deducted by Exchanges from the Liquid Assets of the clearing members on an online, real time basis.

Margins applicable on client positions have to be compulsorily collected from the clients and reported to the Exchange by the members.

### 4.1.9. Minimum Liquid networth<sup>59</sup>

Members of Clearing Corporations in commodity derivatives segment shall maintain a minimum Liquid Net-worth of at least INR 50 Lakhs at all points of time.

### 4.1.10. Base Minimum Capital (BMC)<sup>60</sup>

- I. Exchanges shall have BMC requirements for their members (Trading members) as given below:
  - A. Members without Algo trading – INR 10 Lacs
  - B. Members doing Algo trading – INR 50 Lacs
- II. Clearing members who clear and settle only non-algo trades for other trading members shall have BMC requirement of INR 25 lakhs. Clearing members who clear and settle algo trades shall continue to have BMC requirement of INR 50 lakhs.<sup>61</sup>
- III. No exposure will be given by the Exchange on this BMC.
- IV. 25% of the above deposit shall be in the form of cash and balance 75% can be in the form of Fixed Deposit/Bank Guarantee.

<sup>59</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2018/52](#) dated 21 March 2018

<sup>60</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/86](#) dated 16 Sep 2016

<sup>61</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/77](#) dated 01 September 2016

- V. These funds would be kept in a separate account by the Exchange and would be used only towards the settlement of claims of the client, payment of arbitration fee by the member if any, and dues payable by the member on account of pending arbitration cases/arbitration awards and would not be used by the exchange for meeting any of its other dues.
- VI. BMC would be refunded to the members at the time of surrender of membership provided that there is no unsettled claim against member and no arbitration cases are pending against the member.

#### **4.1.11. Risk Reduction Mode**

Exchanges shall ensure that the trading members/clearing members are mandatorily put in risk-reduction mode when 90% of the member's Liquid Assets available for adjustment against margins/deposits gets utilized for margins/deposits. Such risk reduction mode shall include the following:

- I. All unexecuted orders shall be cancelled once trading member himself or his clearing member breaches 90% collateral utilization level.
- II. Only orders with *Immediate or Cancel* attribute shall be permitted in this mode.
- III. All new orders shall be checked for sufficiency of margins and such potential margins shall be blocked while accepting the orders in the system.
- IV. The trading member shall be moved back to the normal risk management mode as and when the collateral utilization level of the trading member as well as his clearing member is lower than 90%.

#### **4.1.12. Measures in case of repeated shortfall in margin/pay-in<sup>62</sup>**

In case of repeated margin/pay-in shortfalls beyond a threshold amount by any member in a month, following risk mitigation measures shall be initiated by commodity derivatives exchanges:

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<sup>62</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/77](http://SEBI/HO/CDMRD/DRMP/CIR/P/2016/77) dated 01 September 2016



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- I. The member be put in square off mode and required to reduce positions.
- II. The member be charged initial margins at a higher rate for the next one month,  
Or  
The member be subjected to a penal exposure free deposit equal to the cumulative funds/margin shortage over previous one month which could be kept with the exchange for the next month.
- III. Exchange shall keep a close watch on such member.

### 4.1.13. Regaining matched book

In the event of a member/client failing to honor pay-in/margin obligations, exchanges may employ the below given alternative tools to liquidate the positions and regain a matched book based on the conditions of market liquidity, volatility, size of position to be liquidated etc. Any tool lower in the list prescribed hereunder may be resorted to only in extremely rare occasions when the exchange reasonably expects that it may not be able to restore a matched book by choosing the alternatives above it and also records the reasons for the same in writing:

- I. Alternative 1: Liquidation in normal market in orderly manner (with relaxed price limits, if required);
- II. Alternative 2: Auction of the positions within a specified price band
- III. Alternative 3: Voluntary tear-up at last mark-to-market price along with compensation (%age of last mark-to-market price equal to twice the daily price limit) and penalty (5%, to be credited to SGF);
- IV. Alternative 4: Partial tear-up (pro-rata against members/clients having opposite positions) at last mark-to-market price along with compensation (%age of last mark-to-market price equal to thrice the daily price limit) and penalty (5%, to be credited to SGF).

### 4.1.14. Mechanism for regular monitoring of and penalty for short-collection/ non-collection of margins from clients<sup>63</sup>

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<sup>63</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/80](#) dated 7 September 2016

The penalty structure and framework for short-collection/non-collection of margins by members from their clients shall be as under:

- I. The 'margins' for this purpose shall mean initial margin, extreme loss margin (ELM), mark to market margin, special / additional margin, delivery margin or any other margin as prescribed by the Exchange to be collected by member from their clients.
- II. The members are required to collect upfront initial margins and extreme loss margins<sup>64</sup> from their clients. The members will have time till 'T+2' working days to collect margins (except initial margins and extreme loss margins) from their clients. (The clients must ensure that the initial margins and extreme loss margins are paid in advance of trade and other margins are paid as soon as margin calls are made by Exchanges/Members. The period of T+2 days has been allowed to members to collect margin from clients taking into account the practical difficulties often faced by them only for the purpose of levy of penalty and it should not be construed that clients have been allowed 2 days to pay margin due from them.)
- III. The members shall report to the Exchange on T + 5 day the actual short-collection/non-collection of all margins from clients.
- IV. Penalty shall be levied as per the details given below on the members for short / non-collection of margins from their clients beyond T + 2 working days:

For each member	
'a'	Per day penalty as % of 'a'
(< INR 1 lakh) and (< 10% of applicable margin)	0.5
(>= INR 1 lakh) or (>= 10% of applicable margin)	1.0

Where a = short-collection / non-collection of margins per client per day

- V. In case of short-collection /non collection of initial margins and extreme loss margins, the above penalty structure would be applicable from T day.

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<sup>64</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/93](http://SEBI/HO/CDMRD/DRMP/CIR/P/2016/93) dated 26 September 2016



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- VI. The Exchanges should put in place a suitable mechanism to enable the members to report the collection of all margins from their clients at the end of each trading day and to report short collection/non-collection of all margins on the T+5 day.
- VII. All instances of non-reporting shall amount to 100% non-collection of margin and the penalty as prescribed above shall be charged on these instances in respect of non-collection.
- VIII. The penalty shall be collected by the Exchanges not later than five days of the last working day of the trading month.
- IX. With respect to repeated defaulters, who default 3 times or more during a month, the penalty would be 5% of the shortfall in such instances. (Every short/non collection of margin is to be considered as one instance of default. In case margin shortage is reported for a client 3 times or more during a month, i.e., either in consecutive instances or in 3 different instances, the penalty would be 5% of the shortfall from 4th instance of shortfall. E.g. shortage is reported for a client on 1st and 2nd day of month consecutively; thereafter again on 10th day shortage is reported. So the number of instances are 3 and in case shortage is reported on any day later in the month, the penalty shall be 5% of the shortfall amount for all such instances beyond 3rd instance.)
- X. All the penalties collected as prescribed above shall be credited to the Investor Protection Fund.
- XI. Report on the penalties as collected by the Exchanges shall be submitted to SEBI by the 10th day of the following month.
- XII. Exchanges shall examine implementation of these instructions during the inspection of its members. If during inspection or otherwise, incorrect reporting on collection of margin from client by member is found, the member shall be penalized up to 100% of such amount short collected.
- XIII. The Exchange shall direct their members to monitor trades of every client. Suitable mechanism may be put in place to intimate the clients as and when the margins are used up to an appropriate level as considered fit.
- XIV. In exceptional situations wherein members and/or clients were not in position to square off the open positions to avoid levy of penalty for margin shortfall due to lack of adequate liquidity



and/or high market volatility, exchanges may take a suitable decision depending upon the merit of the circumstances and keep SEBI informed of the same. Further, the exchanges are directed to take such exceptional matters to their Board of Directors for decision.

**4.1.15. Settlement Guarantee Fund, Default Waterfall and Stress Testing**

**I. Provisions applicable to Commodity Derivatives Exchanges (till transfer of Clearing and Settlement functions to Clearing Corporations)**

**A. Components of SGF:**

- i. The initial contribution to SGF by the Exchange equal to 5% of the sum total of the Gross revenues of the Exchange for the preceding financial years starting from financial Year 2007-08 or from the date when the Exchange was set up, till the Financial Year 2012-13, subject to a minimum of Rs.10 crores.
- ii. Base minimum capital of members
- iii. Interest accrued on Base Minimum Capital
- iv. All settlement related penalties charged by the Exchange from members with effect from 1st September, 2013
- v. Interest amount and any other income accrued on the investment of funds of SGF shall also be credited to SGF. (The income accruing on the funds belonging to SGF shall be credited to SGF by the Exchange, net of income tax paid on such income).

The exchange shall on quarterly basis, make the risk assessment on Settlement Guarantee Fund (SGF) and shall make fresh contribution to the Settlement Guarantee Fund to meet the shortfall, if any. In cases where exchanges have sufficient funds available in the Settlement Guarantee Fund to meet the contingent risk, then there is no need for exchanges to make any further contribution.

The margin collected by the Exchange from the members shall not be part of SGF.



- B. **Risk assessment for adequacy for SGF:** The risk assessment for adequacy of SGF should be made in compliance with the IOSCO Guidelines, wherein the stress test to determine adequacy of SGF would include both liability for pay in of money and commodities towards settlement obligation and expected losses @ 10% arising on account of unwinding of the open positions of the Top 2 clearing members.
- C. All the monies earmarked to SGF needs to be maintained in a separate account and should be maintained by the investment committee. Further, any income earned on the SGF contributions needs to be retained in the same account and should not be used for any other purpose than meeting settlement obligations.
- D. The SGF status funds should be shown separately in the head of accounts of the Exchange for all accounts purposes.
- E. The Exchange may send a quarterly report to the Regulator on the management of SGF. The said report may include details like opening balance, accruals, income on previous accruals, application of funds, net closing funds, outflows from the fund (if any). The report for the quarter must be sent by the 10th of the following month.
- F. Format for submitting Quarterly Report of Settlement Guarantee Fund by the Commodity Exchanges is as follows:

S. No.	Items	Status of information
1	Opening balance in the SGF (In Rs.) as on	
2	Income of Previous Accruals (IN Rs.)	
3	Accruals during the quarter (In Rs.)	
	Total (A)	
4	Outflows from the Fund during the quarter, if any (In Rs.) (B)	
5	Net closing Fund (IN Rs.) (A-B)	
6	Details of the Application of Funds during the quarter	

S. No.	Items	Status of information
7	Any other information relevant for regulatory purpose	

#### **G. Default Waterfall:**

Till clearing and settlement of trades in commodity derivatives are transferred to clearing corporations, the default waterfall of exchanges shall follow the following order:

- i. Defaulting member's monies (including contribution to SGF)
- ii. Insurance, if any
- iii. Exchange resources equal to 5% of SGF
- iv. SGF resources in the following order:
  - a. Penalties and investment income on SGF
  - b. 25% of Exchange contribution to SGF
  - c. Remaining (non-defaulting members' and exchange) contribution to SGF on pro-rata basis.
- v. Remaining exchange resources (excluding INR 100 Crore\*)
- vi. Capped additional contribution by non-defaulting members (equal to their required contribution to SGF)
- vii. Any remaining loss to be covered by way of pro-rata haircut to payouts.

\*INR 100 Crore to be excluded only when remaining exchange resources are more than INR 100 Crore.

#### **II. Provisions applicable to Clearing Corporations and Stock Exchanges in Commodity Derivatives (Post transfer of Clearing and Settlement Functions)<sup>65</sup>**

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<sup>65</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2018/111](http://SEBI/HO/CDMRD/DRMP/CIR/P/2018/111) dated 11 July 2018



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Clearing Corporations and Stock Exchanges in Commodity Derivatives shall comply with provisions given in **Annexure K** below with respect to Core SGF, Stress Testing and Default Waterfall post transfer of Clearing and Settlement Function from Stock Exchanges to Clearing Corporations. However, Clearing Corporations may continue using the stress testing norms as given in Para **4.1.15 (I)** above till October 10, 2018.

### 4.1.16. Risk management – disclosure by Exchange:<sup>66</sup>

The disablement of terminals of the members along with duration of disablement due to shortage of funds, margin money etc. may be disclosed on the Exchange website for every quarter at the end of i.e.30th June, 30th September, 31st December and 31st March.

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<sup>66</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/93](http://SEBI/HO/CDMRD/DRMP/CIR/P/2016/93) dated 26 September 2016

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## **Chapter 5. Contract Approval and Modification**

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### **5.1. Permission for trading in futures contracts and modification in contract specifications at exchange level<sup>67</sup>**

#### **5.1.1. Check-list of information/details to be submitted along with proposal for launch of new contract or/and for renewal of existing/earlier contracts**

All proposals of exchange for launch of new contract and/or for renewal of existing/earlier contracts shall be accompanied by complete information covering all the points delineated in the check-list appended at **Annexure L**.

The parameters / items listed in the check-list for compliance are illustrative and not exhaustive. Any additional relevant parameter/information as deemed necessary may also be furnished while sending proposal for contracts.

#### **5.1.2. Approval for futures contracts on continuous basis**

The Exchange wise list of contracts approved for continuous trading is placed at **Annexure M**. Approval for continuous trading in futures contracts is contingent upon volume and open interest at the Exchange. Continuous approval for futures trading in the said contracts is subject to the following terms and conditions:

- I. Approval for continuous trading in futures contracts is subject to Rules, Byelaws and Regulations of the concerned Exchange.
- II. Approval for continuous trading granted is for the contract specifications and launch calendar as already approved. Contract specifications and contract launch calendar shall be notified well in advance to the market participants on the website of the Exchange.
- III. Except for the specifications permitted to be modified at exchange level, contracts specifications and contract launch calendar should not be changed without prior approval. For any modification in contract specification or contract launch calendar, the Exchange(s) shall give prior appropriate notice to the market participants. Once the contracts are

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<sup>67</sup> SEBI Circular No. [CIR/CDMRD/DRMP/CIR/2016/88](#) dated 20 Sep 2016



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commenced, no terms of the contract specifications should be changed without prior approval of SEBI.

IV. In case of contracts approved for continuous trading:

- A. If Exchange decides not to launch new contract for trading, then Exchange shall inform market participants well in advance and shall also keep the regulator informed with adequate reasons for not launching of such contract.
- B. If Exchange decides to de-list already running contract(s) having nil open interest, then exchange shall keep the regulator informed with adequate reasons for de-listing the contract(s).
- C. The re-launch of new contracts in case of A and B above shall be with prior approval of SEBI.

V. The contracts approved for continuous trading in agri-commodities shall continue to follow the lean month expiry policy as laid down and shall be subject to any other directions as may be issued by SEBI from time to time. Also, apart from the approved quality standards, the Exchange should ensure that the commodity deposited should comply with the regulations laid down by the other authorities like Food Safety Standard Authority of India, Agmark, BIS etc.

VI. A limit on open position of each member and non-member client and the limit on daily price fluctuation as specified in the contract specification.

VII. The permission granted for the contracts is subject to daily Mark to Market settlement of outstanding contracts as per the procedure and delivery mechanism/process specified in the Bye-laws, the Rules and the Regulations of the Exchange.

VIII. The Exchange, being the first tier regulator, shall ensure that there is no unhealthy speculative trading in the market, which may result in cornering or artificial rigging up or down of the prices by a particular member or group or class of members.

IX. The list of contracts available for trading on continuous basis shall be reviewed by SEBI from time to time

**5.1.3. Permission to allow modification in futures contract specifications at the exchange level**

To ensure that Exchanges are enabled to respond to the market requirements quickly, National Commodity Derivatives Exchanges are permitted to modify the futures contract specifications related to Ticker symbol, Basis, Maximum order size, Trading unit, Delivery unit, Quotation base value, Tick size, Delivery centers, additional delivery centers, issue related to Premium/Discount, Quality parameters and its relevant aspects such as Quantity variation and Tolerance limit in the futures contract specifications. The permission to modify the above parameters of the futures contract specifications is subject to the condition that Exchanges shall invariably inform the market participants and the regulator well in advance before introduction of any modification in contract specifications with reasons for the modifications.



## Chapter 6. Delivery and Settlement

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### 6.1. Staggered delivery, early delivery system, early pay-in facility, penalty on delivery default, fixation on FSP and changes in expiry dates<sup>68</sup>

#### 6.1.1. Staggered delivery

In all futures contracts for which staggered delivery is mandated, the framework shall be as given below:

- I. The tender period shall start with onset of the applicable staggered delivery period. In case the day happens to be a Saturday, Sunday or exchange holiday, the tender period shall start from the next working day.
- II. Seller/buyer shall have an option of marking an intention of giving/taking delivery on any day from start of the tender period up to expiry of the contract.
- III. Exchange shall allocate delivery to buyers having open long position as per random allocation methodology to ensure that all buyers have an equal opportunity of being selected to receive delivery irrespective of the size or value of the position. However, preference may be given to buyers who have marked an intention of taking delivery.
- IV. If the tender date is T, then pay-in and pay-out shall happen latest by T+2th working day.
- V. Open position on expiry of the contract would result in compulsory delivery and would be settled at Final Settlement Price (FSP) of the respective contracts and pay-in and pay-out shall happen latest by the 2<sup>nd</sup> working day after expiry.

#### 6.1.2. Early delivery system

In all futures contracts for which early delivery system is mandated, the framework shall be as given below:

- I. An early delivery period may be provided during E-14 to E-1 days (where E stands for expiry day) of the contract during which buyers/sellers can give intention to take/give delivery. If the intentions of the buyers/sellers match, then the respective positions will be closed out by physical deliveries. The process of pay in and pay-out will be completed on T + 2 basis, where 'T' stands for the day on which matching has been done.

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<sup>68</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/90](#) dated 21 Sep 2016



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- II. If there is no intention matching for delivery between sellers and buyers, then such delivery intention will get automatically extinguished at the close of E-1 day. The intentions can be withdrawn during the course of E-14 to E-1 day if they remained unmatched.
- III. In respect of delivery defaults after the matching of delivery intentions, penalty provisions as applicable in the case of delivery defaults in compulsory delivery contracts will be applied.
- IV. On the expiry of the contract, all outstanding positions would be settled by delivery and all the penalty provisions for delivery default applicable in the compulsory delivery contracts shall apply.

### 6.1.3. Early pay-in facility

- I. Exchanges shall provide early pay-in facility to market participants permitting market participants to deposit certified goods to the Exchange accredited warehouse against relevant futures contracts sold. For such short positions against which early pay-in has been made, based on risk perception, exchanges may exempt imposition of all types of margins. However, Exchanges shall continue to collect mark to market margins from such market participants against such positions.
- II. In case of compulsory delivery and seller's option contracts, delivery to the extent of open position at the expiry of the contract shall be mandatory after claiming early pay-in facility on the position. The exchanges should provide for extremely strict penalties including disciplinary actions against such members who fail to do so.

### 6.1.4. Penalty on delivery default

- I. Penalty on seller in case of delivery default (default in delivery against open position at expiry in case of compulsory delivery contracts, default in delivery after giving intention for delivery) shall be as follows:
  - A. Futures contracts on agri-commodities: 3% of Settlement Price + replacement cost (difference between settlement price and average of three highest of the last spot prices of 5 succeeding days after the commodity pay-out date, if the average price so determined is higher than Settlement Price, else this component will be zero.)



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- B. Futures contracts on non-agri commodities: 3% of Settlement Price + replacement cost (difference between settlement price and higher of the last spot prices on the commodity pay-out date and the following day, if the spot price so arrived is higher than Settlement Price, else this component will be zero.)
- II. Exchanges shall have the flexibility to increase/decrease penalty for specific commodities depending on situation, in consultation with SEBI
- III. **Norms for apportionment of penalty –**
- A. At least 1.75% of Settlement Price shall be deposited in the IPF of the exchange
  - B. Up to 0.25% of Settlement Price may be retained by the Exchange towards administration expenses
  - C. 1% of Settlement Price + replacement cost shall go to buyer who was entitled to receive delivery
- IV. Exchange shall have appropriate deterrent mechanism (including penal/disciplinary action) in place against intentional/wilful delivery default.
- V. Buyer default shall not be permitted.

### 6.1.5. Fixation of Final Settlement Price (FSP)

- I. For contracts where Final Settlement Price (FSP) is determined by polling, unless specifically approved otherwise, the FSP shall be arrived at by taking the simple average of the last polled spot prices of the last three trading days viz., E0 (expiry day), E-1 and E-2. In the event the spot price for any one or both of E1 and E-2 is not available; the simple average of the last polled spot price of E0, E-1, E-2 and E-3, whichever available, shall be taken as FSP. Thus, the FSP under various scenarios of non-availability of polled spot prices shall be as under

Scenario	Polled spot price availability on				FSP shall be simple average of last polled spot prices on:
	E0	E-1	E-2	E-3	
1	Yes	Yes	Yes	Yes/No	E0, E-1, E-2
2	Yes	Yes	No	Yes	E0, E-1, E-3
3	Yes	No	Yes	Yes	E0, E-2, E-3
4	Yes	No	No	Yes	E0, E-3

<b>Scenario</b>	<b>Polled spot price availability on</b>				<b>FSP shall be simple average of last polled spot prices on:</b>
	<b>E0</b>	<b>E-1</b>	<b>E-2</b>	<b>E-3</b>	
5	Yes	Yes	No	No	E0, E-1
6	Yes	No	Yes	No	E0, E-2
7	Yes	No	No	No	E0

- II. In case of non-availability of polled spot price on expiry day (E0) due to sudden closure of physical market under any emergency situations noticed at the basis centre, Exchanges shall decide further course of action for determining FSP in consultation with SEBI.

#### 6.1.6. Change in expiry date

- I. Exchange may advance expiry date of running contract in case physical market is closed in the notified basis centre on the expiry day of the contract, due to festivals, strikes, erratic weather conditions, etc.
- II. Decision about advancing expiry of running contract shall be intimated to the trade participants at least 10 days before the revised expiry date. The delivery period may be advanced accordingly for contract having staggered delivery. The FSP of such contract shall be fixed as per the above procedure (para 6.1.5 above).

### 6.2. Criteria for Settlement Mode of Commodity Derivative Contracts<sup>69</sup>

The following broad guidelines are being specified for deciding appropriate settlement mode for commodity derivatives contracts:

- 6.2.1. The first preference of **settlement** type shall always be by the way of **physical delivery**.
- 6.2.2. Any exemption from the above i.e. cash settlement of commodity derivatives contract, may be considered only in following scenarios with a proper justification –
  - I. Physical delivery is difficult to implement due to any reason, which may inter-alia include the following:
    - A. commodity is intangible; or

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<sup>69</sup> SEBI Circular no [SEBI/HO/CDMRD/DMP/CIR/P/2017/116](http://SEBI/HO/CDMRD/DMP/CIR/P/2017/116) dated October 16, 2017



- B. commodity is difficult to store may be due to low shelf life or inadequate storage infrastructure; or
  - C. it is difficult to physically handle and transport the commodity due to inadequate logistics and transport infrastructure.
- II. There is availability of reliable benchmark price of the commodity which can be used as reference for settlement price. Exchanges shall satisfy themselves that the reference spot price is robust – fair indicator of prevailing prices and not susceptible to any distortion/manipulation.

Subject to the above conditions, both cash settled and physically settled derivative contracts on the same commodity may also be considered for trading, in case basis of price discovery of the proposed contracts is different.

### **6.3. Disclosure of disablement of member terminals<sup>70</sup>**

The disablement of terminals of the members along with duration of disablement due to shortage of funds, margin money etc., shall be disclosed by Exchange on its website at the end of every quarter i.e., 30th June, 30th September, 31st December and 31st March.

### **6.4. Timelines for marking delivery intention**

Exchanges may decide the timelines for submission of delivery instruction by members based on their assessment of the time required for marking as well as for modifying any delivery intentions wrongly marked.

### **6.5. Location premium/discount**

Exchanges shall determine and disclose for contracts the location premium/discount prior to launch of the contract in various commodities.

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<sup>70</sup> SEBI Circular No. [SEBI/HO/CDMRD/DRMP/CIR/P/2016/93](http://SEBI/HO/CDMRD/DRMP/CIR/P/2016/93) dated 26 September 2016

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## **Chapter 7. Investor Protection Fund & Investor service Fund and its related matters**

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The following prescribed norm and guidelines shall be applicable for National Commodity Derivatives Exchanges (NCDEs) with respect to Investor Protection Fund (IPF) and Investor Service Fund (ISF).

### **7.1. Investor Protection Fund (IPF)<sup>71</sup>**

#### **7.1.1. Constitution and Management of the IPF<sup>72</sup>**

- I. The IPF shall be administered by a Trust created for this purpose.
- II. The IPF Trust of the exchange shall have maximum 5 trustees. The IPF Trust shall consist of three public interest directors, one representative from investor associations recognized by SEBI and the compliance officer of the exchange. The maximum tenure of a trustee (excluding the compliance officer of the exchange, whose trusteeship would be co-terminus with the service) shall be five years or as specified by SEBI.
- III. Exchanges shall provide the secretariat for the IPF Trust/Committee.
- IV. Exchanges shall ensure that the funds in the IPF are well segregated from that of the Exchange and that the IPF is immune from any liability of the Commodity Derivatives Exchanges

#### **7.1.2. Contributions to the IPF**

The IPF will be funded as follows:

- I. All the penalties levied and collected by the exchange, except for the settlement related penalties (including penalties from delivery default), shall be credited of the IPF.
- II. 1% of the turnover fee charged by the exchange from its members/brokers or ten lakh whichever is higher in a financial year.

#### **7.1.3. Manner of filing/inviting claims from the Investors/Clients**

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<sup>71</sup> SEBI Circular no. [CIR/HO/CDMRD/DEICE/CIR/P/2016/94](#) dated September 26, 2016

<sup>72</sup> SEBI Circular no. [CIR/HO/CDMRD/DEICE/CIR/P/2016/53](#) dated June 13, 2017

- I. In accordance with its bye-laws, rules or regulations, the Exchange shall publish a notice inviting the legitimate claimants to file claims against the defaulter member within a specified period of time called as the 'specified period'.
- II. The specified period shall be a minimum period of 90 days.
- III. Exchanges shall publish the notice in all the editions of at least one English national daily with wide circulation and in at least one regional language daily with wide circulation at the place(s) where the concerned Exchange Member(s) is/are situated.
- IV. The notice calling for claims shall be displayed on the website of the Exchange for the entire specified period.
- V. The notice shall contain the specified period, the maximum compensation limit for a single claim of an investor/client and all other relevant information.

#### 7.1.4. Eligibility of Claims<sup>73</sup>

- I. The claims received against the defaulter member during the specified period shall be eligible for being considered for compensation from the IPF.
- II. If any eligible claim arises within three years from the date of expiry of the specified period, such claim
  - A. shall be considered eligible for compensation from IPF/CPF in case where the defaulter member's funds are inadequate. In such cases, IPF/CPF Trust shall satisfy itself that such claim could not have been filed during the specified period for reasons beyond the control of the claimant.
  - B. shall not be considered eligible for compensation from IPF/CPF in case where the surplus funds of the defaulter member is returned to the defaulter member. The same shall be borne by the exchanges after scrutinizing and satisfying itself that such claim could not have been filed during the specified period for reasons beyond the control of the claimant.

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<sup>73</sup> SEBI Circular no. [CIR/HO/CDMRD/DEICE/CIR/P/2016/53](#) dated June 13, 2017



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Provided that any claim received after three years from the date of expiry of the specified period may be dealt with as a civil dispute.

- III. The investor claim arising out of a default of a broker/member of the exchange shall be eligible for compensation from IPF.

### 7.1.5. Determination of Legitimate Claims<sup>74</sup>

- I. In case of claims against a defaulter member, the claims of the claimant shall be placed before the defaulters' committee for sanction and ratification. The Defaulters' Committee's advice with respect to legitimate claims shall be sent to IPF Trust for disbursement of the amount.
- II. In case the claim amount is more than the maximum limit for compensation under IPF or the amount sanctioned and ratified by the Defaulters Committee is less than the claim amount, then the investor may prefer for arbitration mechanism for claim of the balance amount.
- III. In the event of default by the member, all transactions executed on the exchange platform shall be eligible for settlement from IPF subject to the appropriate norms laid down by the defaulters' committee. The IPF of the exchange shall be utilized for the clients of SEBI registered members. However, the said amount shall not be more than the maximum limit as prescribed at all time.
- IV. The exchanges shall also use the IPF of the exchange for meeting their liabilities towards the clients of members not registered with SEBI, if the same is allowed under the byelaws of the exchange.<sup>75</sup>

### 7.1.6. Threshold limit for Claims

- I. The Exchanges are free to fix suitable compensation limits, in consultation with IPF trust. However, the amount of compensation available against a single claim of an investor arising out of defaulter by a member broker shall not be less than Rs 1 lakh.
- II. The exchanges in consultation with IPF Trust, shall review and progressively incase the amount of compensation available against a single claim from an investor at least every three year.
- III. Exchanges shall disseminate the compensation limit fixed by them and any change thereof, to the public through a Press Release and through their Website.

<sup>74</sup> SEBI Circular no. [CIR/HO/CDMRD/DEICE/CIR/P/2016/53](#) dated June 13, 2017

<sup>75</sup> SEBI Circular no. [CIR/HO/CDMRD/DCE/CIR/P/2018/49](#) dated March 14, 2018

#### 7.1.7. Disbursements of claims from the IPF

- I. The IPF Trust shall disburse the amount of compensation from the IPF to the investors and such compensation shall not be more than the maximum amount fixed for a single claim of an investor.
- II. The compensation shall be disbursed to the investor from the IPF in case there is a shortage of defaulter broker's assets after its realization.
- III. The Exchange shall ensure that the amount realized from the assets of the defaulter member is returned to the defaulter member after satisfying the claims of the exchanges and SEBI in accordance with the bye-laws of the exchange.

**Provided that** in case of a member broker having membership on multiple exchanges, amount realized from the assets of the defaulter member shall be returned to the said member only after satisfying eligible claims of the concerned exchange, SEBI, and other exchanges as the case may be.

Provided further that in cases where any litigations are pending against the defaulter member, the residual amount, if any, may be retained by the exchange until such litigations are concluded."

- IV. Investment of funds of IPF will be as per the relevant provision of the Indian Trust Act 1882 and Section 11 (5) of Income Tax Act, 1961. The Exchanges are requested to ensure that the investment of trust money is done with utmost caution and prudence.
- V. Appeal should be referred to the Board of the Exchange on any decision of the Managing Committee of IPF regarding any claim.
- VI. In case the National Commodity Derivatives Exchange is wound up, then the balance in the IPF lying un-utilized with the IPF Trust, shall be transferred to SEBI. In such an event, the funds will be maintained in a separate account and SEBI shall act as trustee of these funds. The funds shall be utilized for purposes of investor/client education, awareness, research or other such programme as may be decided by SEBI.
- VII. The IPF Trust shall disburse the compensation to the investors as and when claims have been crystallized against a defaulter member. The IPF Trust need not wait for realization of assets of the defaulter member for disbursement of the claims. Upon receipt of advice of defaulter's committee, for payment, the IPF

Trust shall take necessary steps for disbursement of amount at the earliest.

- VIII. Exchanges shall periodically review the sources of fund and eligible compensation amount so as to recalibrate the fund to make suitable recommendation for enhancement.

**7.1.8. Income earned on IPF and its Utilization<sup>76</sup>:**

- I. The exchange may utilize income earned on the corpus of IPF towards promotion of investor education and awareness programmes through seminars, lectures, workshops, publications (print and electronic media), training programs etc. to enhance literacy and to promote participation in the commodity derivatives market or any other mandated purpose. Capital expenditure would be permissible only w.r.t. setting up of Investor Service Centre. However, no expenditure to be incurred on product promotion in any manner. However, in case of non-utilization of the said income in the same financial year for the mandated purpose, the same shall be ploughed back to IPF. In addition to above, the income earned on the IPF corpus may be utilized in other manner as prescribed/permitted by SEBI in the interest of investors from time to time.
- II. The unutilized IPF interest income accruing during a specific financial year can be carried forward to the next financial year to enable effective utilization of such money by the exchanges during such extended period.
- III. The exchange shall also be permitted to utilize IPF interest income for undertaking research activities related to commodities market, provided every such research activity / project can be undertaken only after obtaining prior written approval of the trustees of the IPF Trust, who would inter alia, record the reasons, relevance and stated objectives of the research project while accordinng approval to such activity/ project. Further, the Board of the exchange may be apprised of the research programs / activities being undertaken at least once in every quarter or half year of a given financial year.

There will be an overall cap on the total amount, not more than 10% of the interest amount of IPF which can be spent on Research activities related to commodities market. IPF shall frame a policy towards identifying / recognising public and private academic institutions, professional bodies, trade (physical market) associations and industry bodies / chambers through / with whom

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<sup>76</sup> SEBI Circular no. [CIR/HO/CDMRD/DEICE/CIR/P/2016/53](#) dated June 13, 2017.



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such Research activities shall be undertaken / organised / sponsored.<sup>77</sup>

- IV. In order to ensure effective utilization of income earned on IPF, supervision of utilization of interest on IPF will rest with the IPF Trust of the exchange.

## 7.2. Investor Service Fund (ISF)<sup>78</sup>

- 7.2.1. Exchanges are mandated to set up Investor Service Fund (ISF) for providing following basis minimum facilities at various Investor Service Centers (ISC).
  - I. The ISC shall provide 4 financial newspapers with at least one in the Regional language.
  - II. The ISC shall install computer software (marketed by some vendors) which provide information about various commodities (agri and non agri) including research reports, general, financial & other important commodity related information. The information will be made available through computers with one master terminal and some dummy terminals through which investors could access this information. Other facilities like copying will be made available to the investors at minimum cost.
  - III. The ISC shall provide facilities for receiving/recording investor complaints. Special staff recruited/deployed by the exchange for this purpose will register the complaints and provide counseling service to the investors. Status of complaints will be maintained and updated in the computer system of the Center.
  - IV. The ISC shall provide for other infrastructure facilities such as telephone, photocopier, furniture, sitting space, internet connection having access to various directions / circulars issued by SEBI and Government agencies etc.
  - V. The ISC shall provide published commodity related materials of exchanges for the benefit of the investors. It should also provide the pamphlets / brouchers detailing the rights and obligation of investors while dealing with brokers in commodity markets, FAQ's etc.
  - VI. The ISC shall provide for dummy terminals to display the prices of the commodities listed on the exchange on real-time basis, to

<sup>77</sup> SEBI Circular no. [CIR/HO/CDMRD/DCE/CIR/P/2018/49](#) dated March 14, 2018

<sup>78</sup> SEBI Circular no. [CIR/HO/CDMRD/DEICE/CIR/P/2016/53](#) dated June 13, 2017



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enable investors watch the price movements of the commodities etc.

- VII. The ISC shall maintain a library on relevant laws, financial analysis, market trend analysis etc. for the education of the investors.
- VIII. The ISC shall conduct various investor education and investor awareness programs through seminars, lectures, workshops, publications (print and electronic media), training programs etc. enhance literacy and promoting participation in the commodity derivatives market.

### 7.2.2. Contribution to ISF

- I. At initial stage, the exchange shall contribute a minimum of Rs Ten Lakhs towards setting up of Investor Service Fund (ISF). Subsequently, onwards, the Exchanges shall transfer the 1% percent of the turnover fees charged by the exchange from its members on monthly basis towards ISF within 7 days of the end of the month, subject to minimum of Rs. Ten Lakh in a financial year.
- II. The Exchange shall also plough back the entire income earned on the corpus of ISF to the ISF within one month from the end of September and March of each year.
- III. The exchange shall be permitted to utilize the corpus of ISF for conducting various investor education and awareness programs, capacity building programs and maintenance of all price ticker boards installed by the respective exchanges, cost of training of arbitrators etc. In addition to above, the corpus may be utilized in other manner as prescribed/permitted by SEBI in the interest of investors from time to time.
- IV. In order to efficient management of ISF, Investor Service Committee (ISC) of exchange shall oversee the contribution to ISF and its utilization.
- V. Exchange shall maintain separate bank account for maintaining corpus of the IPF as well as ISF and such funds should not be co-mingled with any other fund(s) of the exchange and shall not be used for any other purpose.
- VI. SEBI has prescribed certain expenditures which are to be met utilizing the ISF and not IPF. However since ISF is of recent origin, its corpus may be inadequate. NCDEs have therefore



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requested to permit utilizing interest on IPF in lieu of ISF for expenditures meant only for ISF. Accordingly, the NCDEs have been granted 3 years period starting April 1st, 2018 to permit utilizing interest on IPF for activities of ISF also<sup>79</sup>.

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<sup>79</sup> SEBI Circular no. [CIR/HO/CDMRD/DCE/CIR/P/2018/49](#) dated March 14, 2018.

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## **Chapter 8. Investor Grievance Redressal System and Arbitration Mechanism**

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### **8.1. Investor Grievance Redressal System<sup>80</sup>**

The national commodity derivatives exchanges (NCDEs) shall constitute Investor Grievance Redressal Committee (IGRC) for redressal of investor grievances.

In light of the concerns expressed by investors and to decide to mandate that commodity derivatives exchanges having nationwide terminals (MCX, NCDEX, NMCE), functional commodity derivatives exchanges having trading volumes, commodity derivatives exchanges entering into MOUs with other exchanges intending to recommence trading operations shall constitute IGRC at every investor service centre.

**8.1.1. The composition of the IGRC shall be as follows:-**

- I. The IGRC shall comprise of a single person for claims up to Rs. 25 Lakh, whereas, for claims above Rs. 25 Lakh, the IGRC shall comprise of three persons.
- II. The IGRC shall comprise of independent persons with qualifications in the area of law, finance, accounts, economics, management or administration and experience in financial services, including securities market.
- III. Further, the three members Committee shall comprise of at least one technical expert for handling complaints related to technology issues (such as internet based trading, algorithmic trading, etc.).
- IV. The members of IGRC shall not be associated with a trading member in any manner.
- V. Empanelment of IGRC members<sup>81</sup>: Exchanges shall empanel IGRC members, however, no arbitrator/ appellate arbitrator shall be empaneled as IGRC member.
- VI. The disclosures and code of conduct prescribed is given below:
  - A. The name of a person shall be included in the panel after obtaining :

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<sup>80</sup> SEBI Circular No. [CIR/CDMRD/DEICE/02/2015](#) dated November 16, 2015.

<sup>81</sup> SEBI Circular No. [CIR/CDMRD/DEICE/CIR/P/2017/77](#) July 11, 2017.



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- i. a declaration that he has not been involved in any act of fraud, dishonesty or moral turpitude, or found guilty of any economic offence,
- ii. disclosure of the nature of his association with securities market
- iii. disclosure of the names of his dependents associated with the securities market as member, sub-broker or authorized person, and
- iv. an undertaking that he shall abide by the code of conduct prescribed in this circular.

## B. Code of Conduct for IGRC Members

An IGRC Member shall –

- i. act in a fair, unbiased, independent and objective manner;
- ii. maintain the highest standards of personal integrity, truthfulness, honesty and fortitude in discharge of his duties;
- iii. disclose his interest or conflict in a particular case, i.e., whether any party to the proceeding had any dealings with or is related to the IGRC Member;
- iv. not engage in acts discreditable to his responsibilities;
- v. avoid any interest or activity which is in conflict with the conduct of his duties as a IGRC Member;
- vi. avoid any activity that may impair, or may appear to impair, his independence or objectivity;
- vii. conduct IGRC proceedings in compliance with the principles of natural justice and the relevant provisions of the Arbitration and Conciliation Act, 1996, the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956 and the Rules, Regulations and Bye-laws framed thereunder and the circulars, directions issued by the Government / SEBI;
- viii. endeavor to pass IGRC Order expeditiously and in any case not later than the time prescribed in this circular; and
- ix. pass reasoned and speaking IGRC Orders.

8.1.2. With a view to streamline and make more effective the investor grievance redressal mechanism at Exchange, it has been decided to shorten the time taken for the proceedings as well as to give monetary relief to the investors, during the course of pendency of proceedings. In this regard, Exchanges are advised as under:

- I. The exchanges shall ensure that all complaints are resolved at their end within 15. The correspondence with the Member & investor (who is client of a Member) may be done on email if the email id of the investor is available in the UCC database. The Member (Commodity Broker, Trading Member and Clearing

Member) shall provide a dedicated email-Id to the exchange for this purpose.

- II. In case the matter does not get resolved, conciliation process of the exchange would start immediately after the time lines stated in sub-para (a) above.
- III. Investor Grievance Redressal Committee (IGRC) shall be allowed a time of 15 days to amicably resolve the investor complaint.
- IV. IGRC shall adopt a two-fold approach i.e. for proceedings leading to direction to the Member to render required service in case of service related complaints and proceedings leading to an order concluding admissibility of the complaint or otherwise in case of trade related complaints.
- V. In case the matter is not resolved through the conciliation process, IGRC would ascertain the claim value admissible to the investor.
- VI. Upon conclusion of the proceedings of IGRC, i.e. in case claim is admissible to the investor, Exchanges shall block the admissible claim value from the deposit of the Member.
- VII. The exchange shall give a time of 7 days to the Member from the date of signing of IGRC directions as mentioned under sub-para (d) above to inform the Exchange whether the Member intends to pursue the next level of resolution i.e. Arbitration.
- VIII. In case, the Member does not opt for arbitration, the Exchange shall, release the blocked amount to the investor after the aforementioned 7 days.
- IX. In case, the Member opts for arbitration and the claim value admissible to the investor for interim relief paid out of IPF in exchanges is prescribed below<sup>82</sup> :
  - A. In case, award is in favour of client and the member opts for arbitration wherein the claim value admissible to the client is not more than Rs. 20 lakhs (Rs. Twenty lakhs), the following steps shall be undertaken by the Exchange:
    - i. In case the IGRP award is in favour of the client then 50% of the admissible claim value or Rs. 2.00 lakhs (Rs. Two

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<sup>82</sup> SEBI Circular No. [CIR/CDMRD/DEICE/CIR/P/2017/77](#) dated July 11, 2017



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lakhs), whichever is less, shall be released to the client from IPF of the Exchange.

- ii. In case the arbitration award is in favour of the client and the member opts for appellate arbitration then 50% of the amount mentioned in the arbitration award or Rs. 3.00 lakhs (Rs. Three lakhs), whichever is less, shall be released to the client from IPF of the Exchanges. The amount released shall exclude the amount already released to the client at clause (a) above.
- iii. In case the appellate arbitration award is in favour of the client and the member opts for making an application under Section 34 of the Arbitration and Conciliation Act, 1996 to set aside the appellate arbitration award, then 75% of the amount determined in the appellate arbitration award or Rs.5.00 lakhs (Rs. Five Lakhs), whichever is less, shall be released to the client from IPF of the Exchanges. The amount released shall exclude the amount already released to the client at clause (a) and (b) above.
- iv. Total amount released to the client through the facility of interim relief from IPF in terms of this Circular shall not exceed Rs. 10.00 lakhs (Ten lakhs) in a financial year.
- v. Before release of the said amounts from the IPF to the investor, the Exchange shall obtain appropriate undertaking / indemnity from the investor against the release of the amount from IPF, to ensure return of the amount so released to the investor, in case the proceedings are decided against the investor.
- vi. If it is observed that there is an attempt by investor / client either individually or through collusion with Member (s) or with any other stakeholder, to misuse the provision of this Circular, then without prejudice to the powers of the Board to take action, appropriate action in this regard shall be taken against any such person so involved from henceforth accessing the benefits of this Circular.
- vii. In case the complaint is decided in favour of the investor after conclusion of the proceedings, then amount released to the investor shall be returned to IPF from the blocked amount of the Member by Exchange and the rest shall be paid to the investor.

- viii. The Exchanges may devise a detailed procedure with regard to release of funds from IPF and recovery thereof and necessary formats of documents.
  - ix. In case the investor loses at any stage of the proceedings and decides not pursue further, then the investor shall refund the amount released from IPF, back to the IPF. In case the investor fails to make good the amount released out of IPF then investor (based on PAN of the investor) shall not be allowed to trade on any of the Exchanges till such time the investor refunds the amount to IPF. Further, the securities lying in the demat account(s) of the investor shall be frozen till such time as the investor refunds the amount to the IPF.
  - x. The exchanges may also resort to displaying the names of such investors on their websites if considered necessary.
- B. Exchanges, in consultation with the IPF Trust and SEBI, shall review and progressively increase the amount of interim relief available against a single claim for an investor, at least every three years.
- C. The Exchanges shall disseminate the interim relief limit fixed by them and any change thereof, to the public through a Press Release and also through its website.
- 8.1.3. With a view to rationalize the timelines involved in the arbitration mechanism, Exchanges are advised as under:
- I. The Members are required to file application for appellate arbitration within one month of the date of receipt of arbitral award. Further as per section 34 (3) of the Arbitration and Conciliation Act, 1996 the Members have three months to make an application to set aside an arbitral award. In this regard, the Members shall convey their intention to Exchanges within 7 days of receipt of the award, as regards whether such Members desire to challenge the arbitration award/appellate arbitration award in Court or not.
  - II. If the Members do not express their intent to challenge the arbitration award/appellate arbitration award then it would be presumed that Members does not intend to challenge the award and the Exchange shall take further steps accordingly.

In addition to the above, the exchanges shall also take the below mentioned steps:

- 8.1.4. With a view to address complaints regarding 'unauthorised trades' Exchanges are advised to direct the Members to put in place the following:
- I. In case the Member has made margin calls to the client and the client has failed to comply with these margin calls, then the contract note issued by Member for transactions owing to non-compliance of such margin calls would bear a remark specifying the same.
  - II. The Member shall maintain a verifiable record of having made such margin calls and that clients have not complied with the same.
  - III. With a view to assist investors engaged in dispute resolution process, Exchanges shall set up facilitation desks at all investor services centres as specified by SEBI from time to time. These facilitation desks would inter alia also assist investors in obtaining documents/details from Exchanges wherever so required for making application to IGRC and filing arbitration.

## **8.2. Arbitration Mechanism at Commodity Derivatives Exchanges<sup>83</sup>**

- 8.2.1. The Bye-laws of the exchanges relating to arbitration proceedings shall be in accordance with the Arbitration and Conciliation Act, 1996.
- 8.2.2. In consultation with the exchanges, it has been decided to streamline the arbitration mechanism available at exchanges for arbitration of disputes (claims, complaints, differences, etc.) arising between a client and a member (Broker, Trading Member and Clearing Member) across various market segments.
- 8.2.3. An exchange shall provide an arbitration mechanism for settlement of disputes between a client and a member through arbitration proceedings in accordance with the provisions of this Circular read with Section 2(4) of the Arbitration and Conciliation, Act, 1996.
- 8.2.4. Maintenance of a Panel of Arbitrators.
- I. A exchange shall maintain a panel of arbitrators. The number of arbitrators in the panel shall be commensurate to the number of disputes so that an arbitrator handles a reasonable number of

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<sup>83</sup> SEBI Circular No. [CIR/CDMRD/DEICE/CIR/P/2017/77](#) dated July 11, 2017



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references simultaneously and all arbitration references are disposed of within the prescribed time.

- II. The exchange shall have a set of fair and transparent criteria for inclusion of names in the panel of arbitrators.
- III. While deciding to include a particular person in the panel of arbitrators, the exchange shall take into account the following factors:
  - A. age,
  - B. qualification in the area of law, finance, accounts, economics, management, or administration, and
  - C. experience in financial services, including securities market.
- IV. The name of a person shall be included in the panel after obtaining:
  - A. a declaration that he has not been involved in any act of fraud, dishonesty or moral turpitude, or found guilty of any economic offence,
  - B. disclosure of the nature of his association with securities market,
  - C. disclosure of the names of his dependents associated with the securities market as member, sub-broker or authorized person, and
  - D. an undertaking that he shall abide by the code of conduct prescribed in this circular.

### 8.2.5. Code of Conduct for Arbitrators

An arbitrator shall –

- I. act in a fair, unbiased, independent and objective manner;
- II. maintain the highest standards of personal integrity, truthfulness, honesty
- III. and fortitude in discharge of his duties;
- IV. disclose his interest or conflict in a particular case, i.e., whether any party to the proceeding had any dealings with or is related to the arbitrator;
- V. not engage in acts discreditable to his responsibilities;
- VI. avoid any interest or activity which is in conflict with the conduct of his duties as an arbitrator;
- VII. avoid any activity that may impair, or may appear to impair, his independence or objectivity;

- VIII. conduct arbitration proceedings in compliance with the principles of natural justice and the relevant provisions of the Arbitration and Conciliation Act, 1996, the SEBI Act, 1992, the Securities Contracts (Regulation) Act, 1956 and the Rules, Regulations and Bye-laws framed thereunder and the circulars, directions issued by the Government / SEBI;
- IX. endeavour to pass arbitral award expeditiously and in any case not later than the time prescribed in this circular; and pass reasoned and speaking arbitral awards.

#### 8.2.6. Arbitration

- I. The limitation period for filing an arbitration reference shall be governed by the law of limitation, i.e., The Limitation Act, 1963.
- II. An arbitration reference for a claim / counter claim up to Rs.25 lakh shall be dealt with by a sole arbitrator while that above Rs.25 lakh shall be dealt with by a panel of three arbitrators.
- III. The exchange shall ensure that the process of appointment of arbitrator(s) is completed within 30 days from the date of receipt of application from the applicant.
- IV. The arbitration reference shall be concluded by way of issue of an arbitral award within four months from the date of appointment of arbitrator(s).
- V. The Managing Director/ Executive Director of the exchange may for sufficient cause extend the time for issue of arbitral award by not more than two months on a case to case basis after recording the reasons for the same.

#### 8.2.7. Appellate Arbitration

- I. A party aggrieved by an arbitral award may appeal to the appellate panel of arbitrators of the exchange against such award.
- II. An appeal before the appellate panel of arbitrators may be filed within one month from the date of receipt of arbitral award.
- III. The appellate panel shall consist of three arbitrators who shall be different from the ones who passed the arbitral award appealed against.



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- IV. The exchange shall ensure that the process of appointment of appellate panel of arbitrators is completed within 30 days from the date of receipt of application for appellate arbitration.
- V. The appeal shall be disposed of within three months from the date of appointment of appellate panel of such appeal by way of issue of an appellate arbitral award.
- VI. The Managing Director/ Executive Director of the exchange may for sufficient cause extend the time for issue of appellate arbitral award by not more than two months on a case to case basis after recording the reasons for the same.
- VII. A party aggrieved by the appellate arbitral award may file an application to the Court of competent jurisdiction in accordance with Section 34 of the Arbitration and Conciliation Act, 1996.

### 8.2.8. Arbitration Fees<sup>84</sup>

The fee structure (exclusive of statutory dues -stamp duty, service tax, etc.) for filing arbitration reference shall be as follows:-

Amount of Claim / Counter Claim, whichever is higher (in Rs.)	If claim is filed within six months from the date of dispute	If claim is filed after six months from the date of dispute or after one month from the date of IGRP order, whichever is later	If the claim is filed beyond the timeline prescribed in column 3, (only for member)
≤ 10,00,000	1.3% subject to a minimum of Rs.10,000	3.9% subject to a minimum of Rs.30,000	Additional fee of Rs. 3,000/-per month over and above fee prescribed in column 3
> 10,00,000 - 25,00,000 ≤	Rs. 13,000 plus 0.3% amount above Rs. 10 lakh	Rs. 39,000 plus 0.9% amount above Rs. 10 lakh	Additional fee of Rs. 6,000/-per month over and above fee prescribed in column 3

<sup>84</sup> SEBI Circular No. [CIR/CDMRD/DEICE/CIR/P/2017/77](#) dated July 11, 2017.



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<b>Amount of Claim / Counter Claim, whichever is higher (in Rs.)</b>	<b>If claim is filed within six months from the date of dispute</b>	<b>If claim is filed after six months from the date of dispute or after one month from the date of IGRP order, whichever is later</b>	<b>If the claim is filed beyond the timeline prescribed in column 3, (only for member)</b>
> 25,00,000	Rs. 17,500 plus 0.2 % amount above Rs. 25 lakh subject to maximum of Rs. 30,000	Rs. 52,500 plus 0.6 % amount above Rs. 25 lakh subject to maximum of Rs.90,000	Additional fee of Rs. 12,000/-per month over and above fee prescribed in column 3

- I. The filing fee will be utilized to meet the fee payable to the arbitrators. Excess of filing fee over fee payable to the arbitrator, if any, to be deposited in the IPF of the respective exchange.
- II. A client, who has a claim / counter claim up to Rs. 10 lakh and files arbitration reference, will be exempted from filing the deposit. Expenses thus arising with regard to such applications shall be borne by the Exchanges”.
- III. In all cases, on issue of the arbitral award the exchange shall refund the deposit to the party in whose favour the award has been passed. In cases where claim was filed within six months period, the full deposit made by the party against whom the award has been passed, shall be appropriated towards arbitration fees. In cases where claim was filed after six months, one-third of the deposit collected from the party against whom the award has been passed, shall be appropriated towards arbitration fees and balance two-third amount shall be credited to the Investor Protection Fund of the respective stock exchange.

Note : Six months (as referred to in paras 8.2.8 (I), 8.2.8 (II), and 8.2.8 (III) above) shall be computed from the end of the quarter during which the disputed transaction(s) were executed / settled, whichever is relevant for the dispute , and after excluding:-

- A. The time taken by the Investors Grievances Redressal Committee of the Exchange (the time taken from the date of receipt of dispute till the decision by the committee) to



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resolve the dispute under its Rules, Bye-laws & Regulations, and

- B. The time taken by the member to attempt the resolution of the dispute (the time from the date of receipt of dispute by the member to the date of receipt of the member's last communication by the client) or one month from the date of receipt of the dispute by the member, whichever is earlier.
- IV. A party filing an appeal before the appellate panel [as mentioned above 8.2.7 Appellate Arbitration] shall pay a fee not exceeding Rs. 30, 000, as may be prescribed by the exchange, in addition to statutory dues (stamp duty, service tax, along with the appeal. In case the party filing the appeal is a client having claim / counterclaim of up to Rs. 10 lakh, then the party shall pay a fee not exceeding Rs. 10, 000/-.

Further expenses thus arising shall be borne by the Exchanges and the Investor Protection Fund of Exchanges equally.

### 8.2.9. Place of Arbitration / Appellate Arbitration<sup>85</sup>

- I. The exchanges having nationwide terminals, shall provide arbitration facility (i.e. arbitration as well as appellate arbitration) at least at all centres specified by SEBI from time to time. However, the exchanges having nationwide terminals may provide arbitration facility at additional centres, if exchanges so desire. The arbitration and appellate arbitration shall be conducted at the centre nearest to the address provided by Client in the KYC form.
- II. Other exchanges shall provide the arbitration facility, including appellate arbitration, at the place where it is located.
- III. The application under section 34 of the Arbitration and Conciliation Act, 1996, if any, against the decision of the appellate panel shall be filed in the competent Court nearest to the address provided by Client in the KYC form.
- IV. In case award amount is more than Rs. 50 lakh (Rs. Fifty lakh), the next level of proceedings (arbitration or appellate arbitration) may take place at the nearest metro city, if desired

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<sup>85</sup> SEBI Circular No. [CIR/CDMRD/DIECE/02/2015](#) dated November 16, 2015

by any of the party involved. The additional cost for arbitration, if any, to be borne by the appealing party.

**8.2.10. Speeding up grievance redressal mechanism**

In order to have faster implementation of award and to discourage delayed filling of arbitrations by members, the additional fees payable by members who file their claim beyond the prescribed time-lines shall be non-refundable even if the arbitration award goes in favor of the member<sup>86</sup>.

**8.2.11. Public dissemination of profiles of arbitrators.**

In order to enhance transparency and also to provide choice to parties, Exchanges shall disseminate information w.r.t. brief profile, qualification, areas of experience/ expertise, number of arbitration matters handled, pre-arbitration experience, etc. of the arbitrators on their website.

**8.2.12. Submission of documents in soft copies.**

In order to assist the arbitrators in pronouncing comprehensive and speedy awards, Exchanges shall make necessary arrangements in terms of hardware viz., computer, scanner, printer, etc. and required software's at exchange offices/ Investor Service Centers (ISCs) to facilitate the clients to type/ convert their documents into electronic format/ soft copy. Such electronic format/ soft copies shall be provided to the arbitrators along with original submissions in physical copies.

**8.2.13. Review and training of arbitrators**

Investor Service Committee of the Exchanges shall review the performance of the arbitrators annually and submit the review report to the Board of the Exchange. Training need of the arbitrators will be catered by National Institute of Securities Markets (NISM). Cost of training of arbitrators may be incurred from ISF of the exchange.

The NCDEs shall provide training of at least one day to every arbitrator each year<sup>87</sup>.

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<sup>86</sup> SEBI Circular no. [CIR/CDMRD/DCE/CIR/P/2018/48](#) dated March 14, 2018.

<sup>87</sup> SEBI Circular No. [CIR/CDMRD/DCE/CIR/P/2018/48](#) dated March 14, 2018

**8.2.14. Mechanism for implementation of award.**

Exchanges shall create a common database of defaulting clients accessible to members across the Exchanges.

For this purpose, a client may be identified as defaulter if the client does not pay the award amount to the member as directed in the IGRC/ arbitration/ appellate arbitration order and also does not appeal at the next level of redressal mechanism within the timelines prescribed by SEBI or file an application to court to set aside such order in accordance with Section 34 of the Arbitration and Conciliation Act, 1996 (in case of aggrieved by arbitration/ appellate award).

**8.2.15. Empanelment of arbitrators and segregation of arbitration and appellate arbitration panel**

There shall be separate panels for arbitration and appellate arbitration. Further, for appellate arbitration, at least one member of the panel shall be a Retired Judge. Exchanges shall obtain prior approval of SEBI before empanelment of arbitrators/ appellate arbitrators.

**8.2.16. Revision in professional fee of arbitrators**

The arbitrator fee shall be upwardly revised to Rs.18, 000/-(Rs. Eighteen thousand) per case. Consequent to this upward revision, the additional expenses attributable to a client over and above the fee structure as specified in point [8.2.8](#), shall be borne by the client (wherever applicable) and Exchange equally. The total expense attributable to the member has to be borne by the concerned member.

**8.2.17. Arbitration / Appellate Arbitration award**

In order to safeguard the interest of the parties involved in arbitration and to ensure speedy implementation of the arbitration award, the rate of interest on the award passed by arbitrators shall be in compliance with Arbitration and Conciliation (Amendment) Act, 2015.



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8.2.18. Disciplinary Action Committee, Defaulters' Committee, Investors Service Committee, Arbitration Committee<sup>88</sup>

The composition and functions of the Disciplinary Action Committee, Defaulter's Committee and Investors Service Committee will be as follows:

Name of Committee	Functions Handled	Composition
Disciplinary Action Committee	<ul style="list-style-type: none"> <li>i. The Committee shall formulate the policy for regulatory actions including warning, monetary fine, suspension, withdrawal of trading terminal, expulsion, to be taken for various violations by the members of the exchange.</li> <li>ii. Based on the laid down policy, the Committee shall consider the cases of violations observed during inspection, etc. and impose appropriate regulatory action on the members of the exchange.</li> <li>iii. While imposing the regulatory measure, the Committee shall adopt a laid down process, based on the 'Principles of natural justice'.</li> </ul>	<ul style="list-style-type: none"> <li>i. The Committee shall have a minimum of 3 members and a maximum of 5 members;</li> <li>ii. The Public Interest Directors shall form a majority of the Committee;</li> <li>iii. A maximum of two key management personnel of the exchange can be on the committee and one of which shall necessarily be the Managing Director of the exchange;</li> <li>iv. The Committee may also include independent external persons such as retired judge, etc.</li> <li>v. SEBI may nominate members in the Committee, if felt necessary in the interest of commodities market;</li> </ul>
Defaulters' Committee	<ul style="list-style-type: none"> <li>i. To realize all the assets / deposits of the defaulter/ expelled member and appropriate the same amongst various dues and claims against the defaulter/ expelled member in accordance with the Rules, Byelaws and Regulations of the exchange.</li> <li>ii. In the event both the clearing member and his constituent</li> </ul>	<ul style="list-style-type: none"> <li>i. The Committee shall have a minimum of 3 members and a maximum of 5 members;</li> <li>ii. The Public Interest Directors shall form a majority of the Committee.</li> <li>iii. A maximum of two key management personnel of the exchange can be on the Committee.</li> </ul>

<sup>88</sup> SEBI Circular No. [CIR/CDMRD/DEICE/CIR/P/2017/77](#) dated July 11, 2017.



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Name of Committee	Functions Handled	Composition
	<p>trading member are declared defaulter, then the Defaulter's Committee of the exchange and the Defaulter's Committee of the clearing corporation shall work together to realise the assets of both the clearing member and the trading member.</p> <p>iii. Admission or rejection of claims of client/ trading members/ clearing members over the assets of the defaulter/ expelled member.</p> <p>iv. Advise in respect of the claims to the Trustees of the IPF on whether the claim is to be paid out of IPF or otherwise.</p>	<p>iv. The Committee may also include independent external persons such as retired judge, etc.</p> <p>v. SEBI may nominate members in the Committee, if felt necessary in the interest of commodities market;</p>
Investor Services Committee	<p>i. Supervising the functioning of Investors' Services Cell of the Exchange which includes review of complaint resolution process, review of complaints remaining unresolved over long period of time, estimate the adequacy of resources dedicated to investor services, etc.;</p> <p>ii. Supervision of utilization of ISF;</p> <p>iii. To have annual review of the arbitrators and arbitration/ awards (both quantum and quality of the awards).</p>	<p>i. The Committee shall have a minimum of 3 members and a maximum of 5 members.</p> <p>ii. The Public Interest Directors shall form a majority of the Committee.</p> <p>iii. A maximum of two key management personnel of the exchange can be on the Committee.</p> <p>iv. The Committee may also include independent external persons.</p> <p>v. SEBI may nominate members in the Committee, if felt necessary in the interest of commodities market;</p>

It is stipulated that the arbitration panel shall not comprise of any trading members.

#### 8.2.19. Automatic Process and Common Pool of arbitrators<sup>89</sup>:

The national commodity derivatives exchanges shall pool all arbitrators of their exchange in the common pool across all national commodity derivatives exchanges, facilitate automatic selection of arbitrators from the common pool. Details are prescribed below:

- I. List of Arbitrators on the panel of all exchanges having nation-wide trading terminals shall be pooled and will be called a 'Common Pool'. This list shall be made publicly available including by way of display on websites of the exchanges.
- II. 'Common pool' of Arbitrators will consist of Arbitrators listed on the panels of all exchanges having nation-wide trading terminals. The pooling of arbitrators will be done Centre-wise. To illustrate, the list of arbitrators on the panel of all exchanges for the region covered by the Delhi centre will be pooled. This would enable an applicant from the region to choose any arbitrator from the 'Common Pool' for Delhi.
- III. If the client and member (broker, trading member or clearing member) fail to choose the Arbitrator(s) from the Common Pool, the Arbitrator(s) will be chosen by an 'Automatic Process' wherein neither the parties to arbitration (i.e. client or member) nor the concerned Exchanges will be directly involved.
- IV. The 'Automatic Process' will entail a randomized, computer generated selection of Arbitrator, from the list of Arbitrators in the 'Common Pool'. The selection process shall be in chronological order of the receipt of arbitration reference i.e. only after selecting an arbitrator for the former arbitration reference received, selection for the latter shall be taken up.
- V. The 'Automatic Process' will send a system generated, real time alert (sms, email etc.) to all entities involved in the particular case. Further, the communication for the appointment of the Arbitrator will be sent immediately and in any case not later than the next working day from the day of picking of the Arbitrator. This communication will be sent by the exchange on which the dispute had taken place, to all concerned entities including clients, arbitrators, members, exchanges etc.
- VI. The selection of Arbitrators by exchanges as done currently, shall henceforth be replaced by the 'Automatic Process'. In case of any probable conflict of interest in an arbitration reference being

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<sup>89</sup> SEBI Circular No. [CIR/CDMRD/DIECE/02/2015](#) dated November 16, 2015



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assigned to any Arbitrator the Arbitrator will have to upfront decline the arbitration reference. After the said arbitrator declines, the 'automatic process' will pick the name of another Arbitrator. This will continue till the time there is no conflict of interest, by the selected arbitrator. The exchanges should ensure that the process of appointment of arbitrator(s) is completed within 30 days. However, the timeline can be extended and exchanges shall put on record the reasons of such extension.

- VII. In case of conflict of interest by the arbitrator, the information for the same may reach the exchange on which the dispute has taken place within 15 days of receipt of communication from the SE above. The said information may be sent by any method which ensures proof of delivery.
- VIII. Fees of arbitrator shall be dealt in line with existing provisions, by the exchange on which the dispute had taken place.

### 8.2.20. Implementation of Arbitral Award in favour of Clients

- I. In case the arbitral / appellate arbitral award is in favour of the client, the exchange shall, on receipt of the same, debit the amount of the award from the security deposit or any other monies of the member (against whom an award has been passed) and keep it in a separate escrow account.
- II. The exchange shall implement the arbitral award, by making payment to the client, along with interest earned on the amount that has been set aside, as soon as the time for preferring an appeal before the appellate panel of arbitrators has expired and no appeal has been preferred.
- III. The exchange shall implement the appellate arbitral award, by making payment to the client, along with interest earned on the amount that has been set aside, as soon as
  - A. the time for making an application to a Court to set aside such appellate arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996 has expired, and no application has been made, or
  - B. b. when an application to a Court to set aside such appellate arbitral award under Section 34 of the Arbitration and Conciliation Act, 1996, having been made, it has been refused by such Court, or
  - C. c. an application to a Court to set aside such appellate arbitral award under Section 34 of the Arbitration and Conciliation

Act, 1996, having been made, but where no stay has been granted by such Court within a period of three months from the date on which the party making that application had received the appellate arbitral award.

#### 8.2.21. Record and Disclosures

- I. The exchange shall preserve the following documents related to Arbitration:
  - A. the arbitral and appellate arbitral award with acknowledgements, confirming receipt of award by the disputing parties, permanently;
  - B. other records pertaining to arbitration for five years from the date of arbitral award, appellate arbitral award or Order of the Court, as the case may be; and
  - C. register of destruction of records relating to **B above**, permanently.
- II. The exchange shall disclose on its website, details of disposal of arbitration proceedings as per format given in **Annexure N** and details of arbitrator-wise disposal of arbitration of arbitration proceedings as per format given in **Annexure O**
- III. The exchanges shall continue to disclose on their website the arbitration awards (issued since April 01, 2007) in format given in **Annexure P**

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## Chapter 9. Trading Software and Technology

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### 9.1. Annual System Audit<sup>90</sup>

- 9.1.1. The national commodity derivatives exchanges shall conduct annual system audit as per the prescribed audit framework which includes, audit process, auditor selection norms, Terms of Reference (TOR) and audit report guidelines.
- 9.1.2. The Systems Audit Report and compliance status should be placed before the governing board of the exchange and communicated to SEBI along with their comments.
- 9.1.3. System Audit Framework

#### I. Audit Process

Following steps would be repeated annually to ensure that the process is comprehensive & effective:

- A. The Audit shall be conducted according to the Norms, Terms of References (TOR) and Guidelines issued by SEBI.
- B. Stock Exchange / Depository (Auditee) may negotiate and the board of the Stock Exchange / Depository shall appoint the Auditors based on the prescribed Auditor Selection Norms and TOR. The Auditors can perform a maximum of 3 successive audits. The proposal from Auditor must be submitted to SEBI for records.
- C. Audit schedule shall be submitted to SEBI at-least 2 months in advance, along with scope of current audit & previous audit.
- D. The scope of the Audit may be extended by SEBI, considering the changes which have taken place during last year or post previous audit report.
- E. Audit has to be conducted and the Audit report be submitted to the Auditee. The report should have specific compliance / non-compliance issues, observations for minor deviations as well as qualitative comments for scope for improvement. The report should also take previous audit reports in consideration and cover any open items therein.

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<sup>90</sup> SEBI Circular No. [CIR/CDMRD/DEICE/01/2015](#) dated November 16, 2015

- F. The Auditee management provides their comment about the Non-Conformities (NCs) and observations. For each NC, specific time-bound (within 3 months) corrective action must be taken and reported to SEBI. The auditor should indicate if a follow-on audit is required to review the status of NCs. The report along with Management Comments shall be submitted to SEBI, within 1 month of completion of the audit.
- G. Follow-on audit, if any, has to be scheduled within 3 months of the Audit to ensure that the corrective actions have been taken.
- H. If follow-on audit is not required, the Auditee management has to submit a report of actions taken and evidence of corrections to the Auditors & SEBI within 3 months. This report should include updated Issue-Log to indicate the corrective actions taken, verified by the auditors.

## **II. Auditor Selection Norms**

- A. Auditor must have minimum 3 years of experience in IT audit of Securities Industry participants e.g. stock exchanges, clearing houses, depositories etc. The audit experience should have covered all the Major Areas mentioned under SEBI's Audit Terms of Reference (TOR).
- B. The Auditor must have experience in / direct access to experienced resources in the areas covered under TOR. It is recommended that resources employed shall have relevant industry recognized certifications e.g. CISA (Certified Information Systems Auditor) from ISACA, CISM (Certified Information Security Manager) from ISACA, GSNA (GIAC Systems and Network Auditor), CISSP (Certified Information Systems Security Professional) from International Information Systems Security Certification Consortium, commonly known as (ISC)<sup>2</sup>.
- C. The Auditor should have IT audit/governance frameworks and processes conforming to industry leading practices like CobiT.
- D. The Auditor must not have any conflict of interest in conducting fair, objective and independent audit of the Exchange / Depository. It should not have been engaged over the last three years in any consulting engagement with any departments / units of the entity being audited.
- E. The Auditor may not have any cases pending against its previous auditees, which fall under SEBI's jurisdiction, which point to its incompetence and/or unsuitability to perform the audit task.



### III. Terms of Reference (ToR)

- A. General Controls for Data Center Facilities – It must include
  - i. Application access – Segregation of duties, Database & Application access etc.
  - ii. Maintenance access – Vendor engineers.
  - iii. Physical access – Permissions, logging, exception reporting & alerts.
  - iv. Environmental controls – Fire protection, AC monitoring etc.
  - v. Fault resolution mechanism.
  - vi. Folder sharing and Back-up controls – Safeguard critical information on local desktops
  - vii. Incidences of violations in last year & corrective actions taken
- B. Software Change Control – It must include
  - i. User awareness
  - ii. Processing of new feature request
  - iii. Fault reporting / tracking mechanism & process for resolutions
  - iv. Testing of New releases / Bug-fixes – Testing process (automation level)
  - v. Version Control – History, Change Management process etc.
  - vi. Development / Test/ Production environment – Segregation
  - vii. New release in Production – Promotion, Release note approvals
  - viii. Production issues / disruptions reported during last year & corrective actions taken
- C. Data communication / Network controls – It must include
  - i. Network Administration – Redundancy, Monitoring, breakdown resolution etc.
  - ii. WAN Management – Connectivity provisions for business continuity.
  - iii. Encryption - Router based as well as during transmission
  - iv. Connection Permissions – Restriction on need to have basis
  - v. Fallback mechanism – Dial-up connections controls etc.
  - vi. Hardware based Signing Process
  - vii. Incidences of access violations in last year & corrective actions taken
- D. Security Controls – General office infrastructure – It must include
  - i. Security Policy & quality of implementation of the same
  - ii. LAN security control and monitoring



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- iii. OS & Database Security controls & monitoring
  - iv. Internet connection controls – Firewall protection, Intrusion Detection System, Access rights and privileges.
  - v. Virus protection – Controls to mitigate the Virus attacks / Outbreaks.
  - vi. Secured (digitally signed) e-mail with other entities like SEBI, other partners
  - vii. Email Archival Implementation
  - viii. Incidences of security violations in last year & corrective actions taken
- E. Access policy and controls
- F. Electronic Document controls
- G. General Access controls
- H. Performance audit – It must include
- i. Comparison of changes in transaction volumes since previous audit
  - ii. Review of systems (hardware, software, network) performance over period
  - iii. Review of the current volumes against the last Performance Test performed
- I. Business Continuity / Disaster Recovery Facilities – It must include
- i. BCP manual, including Business Impact Analysis, Risk Assessment and DR process
  - ii. Implementation of policies
  - iii. Back-up procedures and recovery mechanism using back-ups.
  - iv. Storage of Back-up (Remote site, DRS etc.)
  - v. Redundancy – Equipment, Network, Site etc.
  - vi. DRS installation and Drills - Management statement on targeted resumption capability (in terms of time required & extent of loss of data)
  - vii. Evidence of achieving the set targets during the DRS drills in event of various disaster scenarios.
  - viii. Debrief / review of any actual event when the DR/BCP was invoked during the year
- J. IT Support & IT Asset Management – It must include
- i. Utilization monitoring – including report of prior year utilization
  - ii. Capacity planning – including projection of business volumes



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- iii. IT (S/W, H/W & N/W) Assets, Licenses & maintenance contracts
- iv. Insurance
- v. Disposal – Equipment, Media, etc.

## K. Entity Specific Software

## L. Any other Item

- i. Electronic Waste Disposal
- ii. Based upon previous Audit report as well as any other specific information given by SEBI

## **IV. Audit Report Guidelines**

- A. The Audit report should have explicit coverage of each Major Area mentioned in the TOR, indicating any Nonconformity (NCs) or Observations (or lack of it).
- B. For each section – auditors should also provide qualitative input about ways to improve the process, based upon the best practices observed.
- C. The report should also include tabulated data to show NCs / Observations for each Major Area in TOR
- D. Fully detailed report should be submitted, along with an Executive Summary in tabulated form including following information:

<b>Issue Log Column Heading</b>	<b>Description</b>	<b>Responsibility</b>
Major Area	Major area/relevant clause in Terms of Reference against which compliance is being audited	Auditor
Description of Finding/ Observation	Describe the findings in sufficient detail, referencing any accompanying evidence (e.g. procedure manual, interview notes, reports etc.)	Auditor
Reference	Reference to the section in detailed report – where full background information about the findings are available	Auditor
Process/ Unit	Process or unit where the audit is conducted and the finding pertains to	Auditor
Category of Findings	Major/Minor Nonconformity, Observation, Suggestion etc.	Auditor



<b>Issue Log Column Heading</b>	<b>Description</b>	<b>Responsibility</b>
Audited By	Which Auditor covered the findings	Auditor
Root Cause Analysis	A detailed analysis on the cause of the nonconformity	Auditee
Remediation	The action (to be) taken to correct the nonconformity	Auditee
Target Completion Date for Remedial Action	The date by which remedial action must be/will be completed	Auditor/Auditee
Status	Status of finding on reporting date (open/close)	Auditor/Auditee
Verified By	Auditing personnel (upon verification that finding can be closed)	Auditor
Closing Date	Date when finding is verified and can be closed	Auditor

- E. The Executive Summary should also include an overall comment from the Auditors to indicate if a follow-on audit is required and the time lines of respective corrective action for non-conformities.
- F. Further, along with the audit report, the Stock Exchange / Depository shall also submit a declaration from the MD / CEO certifying the integrity and security of IT Systems

## 9.2. Business Continuity Plan (BCP) and Disaster Recovery (DR)<sup>91</sup>

9.2.1. The national commodity derivatives exchanges shall have BCP & DR policy in place and implement the broad guidelines regarding the setting up of Disaster Recovery Site (DRS) and Near Site (NS), Configuration of DRS/NS with Primary Data Centre (PDC), DR drills / Testing, BCP DR Policy as mentioned below:

- I. The exchanges should have in place Business Continuity Plan (BCP) and Disaster Recovery Site (DRS) so as to maintain data and transaction integrity.
- II. Apart from DRS, exchanges should also have a Near Site (NS) to ensure zero data loss.
- III. The DRS should be set up sufficiently away, i.e. in a different seismic zone, from Primary Data Centre (PDC) to ensure that both DRS and PDC are not affected by the same disasters.

<sup>91</sup> SEBI Circular No. [CIR/CDMRD/DEICE/01/2015](#) dated November 16, 2015

IV. The manpower deployed at DRS / NS should have similar expertise as available at PDC in terms of knowledge / awareness of various technological and procedural systems and processes relating to all operations such that DRS / NS can function at short notice, independently.

#### **V. Configuration of DRS / NS with PDC**

- A. Hardware, system software, application environment, network and security devices and associated application environments of DRS / NS and PDC should have one to one correspondence between them.
- B. Exchanges Depositories should have Recovery Time Objective (RTO) and Recovery Point Objective (RPO) not more than 4 hours and 30 minutes, respectively.
- C. Solution architecture of PDC and DRS / NS should ensure high availability, fault tolerance, no single point of failure, zero data loss, and data and transaction integrity.
- D. Any updates made at the PDC should be reflected at DRS / NS immediately (before end of day) with head room flexibility without compromising any of the performance metrics.
- E. Replication architecture, bandwidth and load consideration between the DRS / NS and PDC should be within stipulated RTO and ensure high availability, right sizing, and no single point of failure.
- F. Replication between PDC and NS should be synchronous to ensure zero data loss. Whereas the one between PDC and DR and between NS and DR may be asynchronous.
- G. Adequate resources (with appropriate training and experience) should be available at all times to handle operations on a regular basis as well as during disasters.

#### **VI. DR Drills / Testing**

- A. DR drills should be conducted on quarterly basis. In case of exchanges, these drills should be closer to real life scenario (trading days) with minimal notice to DR staff involved.
- B. During the drills, the staff based at PDC should not be involved in supporting operations in any manner. To begin with, initial three DR drills from the date of this circular may be conducted with the support of staff based at PDC.
- C. The drill should include running all operations from DRS for at least 1 full trading day.
- D. Before DR drills, the timing diagrams clearly identifying resources at both ends (DRS as well as PDC) should be in place.
- E. The results and observations of these drills should be documented and placed before the Governing Board of Stock Exchange /

Depositories. Subsequently, the same along with the comments of the Governing Board should be forwarded to SEBI within a month of the DR drill.

- F. The system auditor while covering the BCP – DR as a part of mandated annual system audit should also comment on documented results and observations of DR drills.

## **VII. BCP – DR Policy Document**

- A. The BCP – DR policy of national commodity derivatives exchanges should be well documented covering all areas as mentioned above including disaster escalation hierarchy.
  - B. The exchanges should specifically address their preparedness in terms of proper system and infrastructure in case disaster strikes during business hours.
  - C. Depositories should also demonstrate their preparedness to handle any issue which may arise due to trading halts in stock exchanges.
  - D. The policy document and subsequent changes / additions / deletions should be approved by Governing Board of the exchange and thereafter communicated to SEBI.
- VIII. Further, the exchanges should also ensure that point VI (F) mentioned above is also included in the scope of its annual system audit.

### **9.3. Annual System Audit of Stock Brokers / Trading Members of National Commodity Derivatives Exchanges<sup>92</sup>**

- 9.3.1. The exchanges should ensure that system audit of stock brokers/ trading members are conducted in accordance with the prescribed framework as placed below as **Annexure Q**.
- 9.3.2. Exchanges are advised to keep track of findings of system audits of all brokers on quarterly basis and ensure that all major audit findings, specifically in critical areas, are rectified / complied in a time bound manner failing which follow up inspection of such brokers may be taken up for necessary corrective steps / actions thereafter, if any.
- 9.3.3. Stock Exchange should report all major non-compliances / observations of system auditors, broker wise, on a quarterly basis to SEBI.

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<sup>92</sup>SEBI Circular No. [SEBI/HO/CDMRD/DEICE/CIR/P/2016/70](#) dated August 11, 2016

- 9.3.4. Further, it was decided that Type I brokers may be exempted from system audit and the development of NEAT / BOLT / Exchange provided terminals be included in the scope of Annual System Audit of National Commodity Derivatives Exchanges.
- 9.3.5. In view of above, the provisions relating to Type I Brokers, as mentioned in this circular, shall not be applicable to Type I Brokers. However, such provisions shall be included in the TOR of the Annual System Audit for National Commodity Derivatives Exchanges.

**9.4. Testing of software used in or related to Trading and Risk Management<sup>93</sup>**

- 9.4.1. Due to technological developments and innovations, currently the members of exchanges have multiple options for using software i.e. either exchange provided or in-house developed software which is being used for trading and risk management related activities. Since new software or changes to the existing software without proper testing may affect the integrity of the markets, it has been decided to make the applicable the following provisions to commodity derivatives markets.
- 9.4.2. '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.
- 9.4.3. Testing of Software

In addition to the testing and approval requirements specified through various circulars issued by SEBI on IBT, DMA, STWT, SOR and AT, stock exchanges shall frame appropriate testing policies for functional as well as technical testing of the software. Such framework shall at the minimum include the following:

- I. Testing in a simulated test environment: National commodity derivatives exchanges shall provide suitable facilities to market participants / software vendors to test new software or existing

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<sup>93</sup> SEBI Circular No. [CIR/CDMRD/DEICE/03/2015](#) dated December 11, 2015



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software that have undergone change. Subjecting the new software or existing software that have undergone change to such testing facility shall be mandatory for market participants, before putting it in use.

## II. Mock testing

- A. National commodity derivatives exchanges shall organize mock trading sessions on regular basis, at least once in a calendar month, to facilitate testing of new software or existing software that has undergone any change of functionality, in a close-to-real trading environment. Stock exchanges shall suitably design and plan such mock trading sessions to ensure maximum participation and sufficient trading volumes for the purpose of testing.
  - B. National commodity derivatives exchanges shall mandate a minimum time period for such testing in the mock trading sessions.
  - C. In order to improve the efficacy of the mock trading sessions, all stock brokers / trading members shall ensure that all user-ids approved for Algo trading, irrespective of the algorithm having undergone change or not, shall participate in the mock trading sessions.
  - D. User Acceptance Test (UAT): The broker / trading member shall undertake UAT of the software to satisfy itself that the newly developed / modified software meets its requirements.
- III. With respect to testing of software related to (a) fixes to bugs in the software, (b) changes undertaken to the stock brokers' software / systems pursuant to a change to any stock exchange's trading system, and (c) software purchased from a software vendor that has already been tested in the mock environment by certain number of stock brokers, stock exchanges may prescribe a faster approval process to make the process of approval expeditious.
- 9.4.4. Brokers / trading members shall also engage system auditor(s) to examine reports of mock tests and UAT in order to certify that the tests were satisfactorily undertaken.

- 9.4.5. National commodity derivatives exchanges shall monitor compliance of stock brokers / trading members, who use trading algorithm, with regard to the requirement of participation in mock trading session as mandated with this circular. In cases where stock exchanges find that the stock broker / trading member has failed to participate in such mock trading sessions, stock exchange shall call for reasons and if found unsatisfactory, shall suspend the proprietary trading rights of the stock broker / trading member for a minimum period of one trading day.
- 9.4.6. National commodity derivatives exchanges shall also ensure that the system auditors examine the compliance of stock broker / trading member, who use trading algorithms, with regard to the requirement of participation in mock trading session, as mandated with this circular, and provide suitable comments in the periodic system audit report. In cases where the system audit report indicate that the stock broker / trading member has failed to participate in such mock trading sessions, stock exchange shall call for reasons from the broker/trading member and if found unsatisfactory, shall suspend the proprietary trading rights of the broker / trading member for a minimum period of one trading day.
- 9.4.7. For pre-approval / periodic system audit of Computer-to-Computer Link (CTCL) or Intermediate Messaging Layer (IML), IBT, DMA, STWT, SOR and AT, brokers / trading members shall engage a system auditor with any of the following certifications :
- CISA: (Certified Information System Auditors) from ISACA;
  - DISA: (Post Qualification Certification in Information Systems Audit) from Institute of Chartered Accountants of India (ICAI);
  - CISM: (Certified Information Securities Manager) from ISACA
  - CISSP: (Certified Information Systems Security Professional) from International Information Systems Security Certification Consortium, commonly known as (ISC)2.

While finalizing the system auditor, stock brokers / trading members shall ensure the system auditor does not have any conflict of interest with the stock broker and the directors/promoters of the system auditor are not directly or indirectly related to the current directors or promoters of stock broker / trading member.

**9.4.8. Approval of Software of broker / trading member**

- I. Brokers / trading members shall seek approval of the respective exchanges for deployment of the software in the securities market by submitting necessary details required by exchange including details of software, tests undertaken and certificate / report provided by the system auditor. Exchange may seek additional details as deemed necessary for evaluating the application of the stock broker / trading member.
- II. National commodity derivatives exchanges shall grant approval or reject the application of the stock broker as the case may be, and communicate the decision to the stock broker / trading member within fifteen working days from the date of receipt of completed application (or within any other such time period specified vide SEBI circulars on DMA, IBT, STWT, SOR, AT, etc.). In case of rejection of the application, the stock exchange shall also communicate reasons of rejection to the stock broker / trading member within such time period.
- III. Before granting approval to use software in commodities derivatives market, National commodity derivatives exchanges shall ensure that the requirements specified by SEBI / exchange with regard to software are met by the broker / trading member.
- IV. National commodity derivatives exchanges may suitably schedule the requirements of mock testing, certification of test reports by system auditor(s) and the software approval process, so as to facilitate a speedy approval and a smooth transition of the stock brokers to the new / upgraded software.

**9.4.9. In order to ensure that brokers are not using software without requisite approval of the National commodity derivatives exchanges, exchanges are advised to put in place suitable mechanism to prevent any unauthorized change to the approved software.**

**9.4.10. Undertaking to be provided by brokers / trading members**

- I. Brokers / trading members shall submit an undertaking to the respective stock exchanges stating the following at the minimum:
  - A. M/s ..... will take all necessary steps to ensure that every new software and any change thereupon to the trading and/or risk management functionalities of the



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software will be tested as per the framework prescribed by SEBI / stock exchange before deployment of such new / modified software in securities market.

- B. M/s \_\_\_\_\_ will ensure that approval of the stock exchange is sought for all new / modified software and will comply with various requirements specified by SEBI or the stock exchange from time to time with regard to usage, testing and audit of the software.
  - C. The absolute liability arising from failure to comply with the above provisions shall lie entirely with M/s \_\_\_\_\_  
member.
- II. National commodity derivatives exchanges may include additional clauses as deemed necessary in the undertaking.
- 9.4.11. Sharing of Application Programming Interface (API) specifications by the exchange with brokers / trading members.
- I. API is an interface that enables interaction of software with other software and typically includes language and message format that is used by an application program to communicate with the operating system or other application program. Brokers / trading members and software vendors require relevant API specifications to facilitate interaction of the developed software with the systems of the stock exchanges.
  - II. Technical Advisory Committee (TAC) had engaged with stock exchanges, software vendors and stock brokers / trading members to review the framework of sharing of APIs by stock exchanges.
  - III. Based on the recommendations of the committee, it is decided that National commodity derivatives exchanges shall provide relevant API specifications to all brokers / trading members and software vendors who are desirous of developing software for the securities market, after establishing their respective credentials.
  - IV. In case of refusal to share APIs, exchanges shall provide reasons in writing to the desirous stock brokers / trading members or software vendors within a period of fifteen working days from the date of receipt of such request for sharing of API.
  - V. Further, exchanges shall not selectively release updates / modifications, if any, of the existing API specifications to few brokers / trading members or software vendors ahead of others and shall provide such updated / modified API specifications to all

stock brokers / trading members and software vendors with whom the earlier API specifications were shared.

- 9.4.12. **Penalty on malfunction of software used by broker / trading member:** National commodity derivatives exchanges shall examine the cases of malfunctioning of software used by brokers / trading members and apply deterrent penalties in form of fines or suspension to the stock broker/trading member whose software malfunctioned. In addition, brokers/trading members shall implement various mechanisms including the following to minimize their losses in the event of software malfunction:
- I. include suitable clauses in their agreement with the software vendors to define liabilities of software vendor and broker / trading member in case of software malfunction, and / or,
  - II. consider taking suitable insurance cover to meet probable losses in case of software malfunction.
- 9.4.13. With regard to changes / updates to broker's trading software that intend to modify the 'look and feel' and do not affect the risk management system of the broker or the connectivity of the trading software with exchange's trading system, it is clarified that mock testing and consequent system audit may not be insisted upon by the exchanges.
- 9.4.14. National commodity derivatives exchanges shall direct their brokers to put in place adequate mechanism to restore their trading systems to 'production state' at the end of testing session so as to ensure integrity of stock brokers' trading system

## **9.5. Cyber Security and Cyber Resilience framework<sup>94</sup>**

- 9.5.1. SEBI as a member of IOSCO has adopted the Principles for Financial Market Infrastructures (PFMIs) laid down by CPMI - IOSCO and has issued guidance for implementation of the principles in the securities market.
- 9.5.2. Principle 17 of PFMIs that relates to management and mitigation of 'Operational risk' requires that systemically important market infrastructures institutions "should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures, and controls. Systems should be

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<sup>94</sup> SEBI Circular No. [SEBI/HO/CDMRD/DEICE/CIR/P/2016/0000000044](http://SEBI/HO/CDMRD/DEICE/CIR/P/2016/0000000044) dated March 29, 2016

designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business continuity management should aim for timely recovery of operations and fulfilment of the FMI's obligations, including in the event of a wide -scale or major disruption."

- 9.5.3. Commodity derivatives exchanges referred as Market Infrastructure Institutions or MIIs are systemically important market infrastructure institutions. As part of the operational risk management, these MIIs need to have robust cyber security framework to provide essential facilities and perform systemically critical functions relating to trading, clearing and settlement in securities market.
- 9.5.4. National commodity derivatives exchanges are required to comply the framework with regard to cyber security and cyber resilience as placed as **Annexure R**.

**Annexures**

### Annexure A

#### Report on Shareholding Pattern of the Exchange in terms of Securities contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012

[Quarter ended \_\_\_\_\_]

##### A. Top ten shareholders during the quarter

Sl. No.	Name of the shareholder	Number of shares held at the end of the quarter	Percentage of shareholding
1			
2			

##### B. Shareholders falling under Regulation 17 who have acquired shares during the quarter

Sl. No.	Name of the shareholder who acquired shares	Name of the shareholder from whom shares acquired	Number of shares acquired during the quarter	Percentage of Shareholding after the acquisition
1				
2				

##### C. Category wise shareholding pattern in the recognised commodity derivative exchange (along with the names of the shareholder)-

##### I. TRADING MEMBER

Sl. No	Category of shareholder	No. of Shareholder	Total number of Shares	Percentage of Shares
	Individuals			
1				
2				
	Corporates(Listed)			
1				
	Corporates(unlisted)			
1				
	Banks (wherever permitted)			
1				
	Any other (specific)			
	<b>Total (A)</b>			

## II. ASSOCIATES OF TRADING MEMBERS

Sr. No	Category of Shareholder	No. of Shareholders	Total number of shares	Percentage of shares
	Individuals			
1				
2				
	Corporates(listed)			
1				
	Corporates(unlisted)			
1				
	HUF			
1				
	Trust			
1				
	Financial Institutions / Banks			
1				
	Foreign Holding (FDI)			
1				
	Foreign Holding (FII)			
1				
	Any other (specify)			
	<b>Total (B)</b>			
	<b>Total(A+B)</b>			

## III. PUBLIC SHAREHOLDING

Sr. No.	Category of shareholder	No. of Shareholders	Total number of shares	Percentage of shares
	Individuals			
1				
2				
	Corporates (Listed)			
1				
	Corporates (Unlisted)			
1				
	HUF			
1				
	Trust			
1				

Sr. No.	Category of shareholder	No. of Shareholders	Total number of shares	Percentage of shares
	Financial Institutions / Banks			
1				
	Foreign Holding (FDI)			
1				
	Foreign Holding (FII)			
1				
<b>Any Other (specify)</b>				
	Insurance Companies			
1				
	Mutual Funds			
1				
	Venture Capital Fund			
1				
	Any other (specify)			
	<b>Total (C)</b>			
	<b>Grand total (A)+(B)+(C)</b>			

#### **D. SHAREHOLDERS ACTING IN CONCERT**

The Exchange shall indicate the shareholding pattern in the format given below in respect of each set of shareholders, in case they hold shares along with persons acting in concert-

Sr. No.	Name of the shareholder	Category of shareholder	Details of holding	
			Number of shares	Percentage
1				
2				
3				

**UNDERTAKING UNDER REGULATION 21**

E. The Managing Director/ Executive Director of the recognized commodity derivative exchange shall submit an undertaking confirming the compliance of the provisions Regulation 21 of Securities Contracts (regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 to SEBI on a quarterly basis within fifteen days from the end of each quarter and to monitor and ensure compliance with the provisions under Chapter – IV of the said SECC Regulations at all times.



Annexure B

MARKET DEVELOPMENT REPORT OF \_\_\_\_\_ EXCHANGE FOR THE PERIOD \_\_\_\_\_  
SECTION I

1. STATISTICAL DETAILS - CURRENT FINANCIAL YEAR

IMPORTANT: The cumulative figures are for the current Financial Year.

Items	Apr	May	Jun			Feb	Mar	Cumulative total for the year
No. of Trading days A. Total value of trade (in INR Crores) Total Volume of trade (in MT) Total number of contracts traded  B. Agri Commodities Total value of trade (in INR Crores) Total Volume of trade (in MT) Total number of contracts traded  C. Non-Agri commodities Total value of trade in (in INR Crores) Total Volume of trade (in MT) Total number of contracts traded								



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**2. NO. OF CONTRACTS AVAILABLE FOR TRADING**

Commodities on which futures contracts are available*	Number of running contracts on each commodity	No. of liquid contracts*	No. of illiquid contracts
<i>Note: *please provide criteria for liquid contracts</i>			

**3. COMMODITY WISE DETAILS**

Items (Name of Commodity)	Apr	May	Jun		Feb	Mar	Cumulative total for the year
Total value of trade in INR Crores							
Total Volume of trade in MT							
Total number of contracts traded							

**4. MOVEMENT OF THE INDICES COMPILED BY THE EXCHANGE (CLOSING VALUES ONLY)**

Index	Open (First Day)	High (With Date)	Low (With Date)	Close (Last Trading Date)

**5. TRADING TERMINALS RELATED INFORMATION**

- The number of cities covered across the country
- Total number of trading terminals set up across the country
- The number of trading terminals set up abroad, if any



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## 6. DETAILS OF SPECIFIC PURPOSE FUNDS

### a) Investor Protection Fund

Composition of the Fund	IPF/CPF
Corpus as per previous Development Report	
Add : Accruals to the Fund during the period	
Less : Fund utilised during the period	
Corpus as of end of the period	
Composition of Fund	

## 7. CLEARING, SETTLEMENT & RELATED FUNCTIONS

### 1. Clearing and Settlement for Commodity Derivatives –

Sr. No	Average Daily Settlement Value (INR Crores)*	Highest Settlement Value for the Month (INR Crores)

*Average Daily Settlement Value = Total Settlement Value for the Month/ Total number of trading days*

### 2. Top 10 Settlement Shortages

Sr. No	Name of Member	Shortage in Commodity/ Contract	Date of Settlement (for which there was a shortage)	Number of times the Member had settlement shortages in the previous 6 months	Shortage Type (Funds/ Commodities)	Amount (INR Crores)



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**3. Top 10 Clearing Members based on highest 'Daily Average Pay-In' obligation**

Sr. No	Name of Clearing Member	Category (CM/SCM/PCM)	Amount (INR crores) *

**8. DISCIPLINARY ACTION TAKEN AGAINST MEMBERS**

Sr. No.	Name of member	Nature of irregularity /violation	Details of action taken

Note: The details pertaining to cases of deactivation of terminals for three consecutive days or more should be furnished.

**9. DEFAULT OF MEMBERS**

Name of member declared defaulter during the period	Date of default	Cumulative no. of default cases during the current financial year

**10. DETAILS PERTAINING TO DISRUPTIONS IN TRADING, IF ANY**



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**SECTION II**

**1. COMPLAINTS RECEIVED FROM INVESTORS**

a. Complaints against brokers

Pending at the beginning	Received	Resolved	Pending at the end	No. of complaints pending for more than one month and brief reasons thereof

b. Complaints referred by SEBI against the brokers

Pending at the beginning	Received	Resolved	Pending at the end	No. of complaints pending for more than one month and brief reasons thereof

**2. COMPLAINTS AGAINST EXCHANGE**

a. By investors

Pending at the beginning	Received	Resolved	Pending at the end	No. of complaints pending for more than one month and brief reasons thereof

b. By members

Pending at the beginning	Received	Resolved	Pending at the end	No. of complaints pending for more than one month and brief reasons thereof



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**3. ARBITRATION (MEMBER VS NON-MEMBER)**

a. Details of arbitration cases

Pending at the beginning	Received	Awards passed		For "X" the amount set aside by the Exchange		Pending at the end	Details of arbitration cases which are pending for more than three months along with reasons
		In favour of non-member "X"	In favour of member	No of cases	Amount in INR		

**4. DETAILS OF IMPLEMENTATION OF ARBITRATION AWARDS**

a. Member-wise statement of unimplemented awards (where the money has not been set aside)

S. No	Name of the member	Number of awards un-implemented	Amount involved	Action taken by the Exchange

b. Complaints received by the Exchange against the Arbitration mechanism of the Exchange

Opening balance	Complaints received during the month	Resolved during the month	Nature of the complaint	Closing balance	Comment of the exchange



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**SECTION III**

**1. GOVERNING BOARD AND STATUTORY COMMITTEES (To be reported in case of change)**

- a. Composition of Governing Board/Council of Management:

Names	Category	Date of Appointment	Date of Last Renewal of the term	No. of terms completed	Date of Expiry of current term

**2. ATTENDANCE DETAILS OF NON-MEMBER DIRECTORS ON GOVERNING BODY OF THE EXCHANGE**

<b>Date of Meetings held</b>	Name of Non-member Directors attended the meeting along with their category		
	<b>Date of issue of Notice convening the meetings</b>	Name of Non-member Directors	Name of Non-member Directors

**3. IMPORTANT DECISIONS TAKEN BY GOVERNING BOARD/ COUNCIL OF MANAGEMENT IN THE MEETING(S).**



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**SECTION IV**

**1. INSPECTION OF MEMBERS**

Total no. of members	No. of active members	No. of members inspected during the period	Cumulative number of members inspected during the current FY	% of active members inspected during the year

**2. STATUS OF IMPLEMENTATION OF CIRCULARS ISSUED BY SEBI DURING THE PAST THREE MONTHS**

Circular No. & date	Provisions in the circular(Subject)	Implemented (Y/N)	Date of implementation of the provisions	In case, not implemented reasons for non-implementation

**3. ANY OTHER IMPORTANT DEVELOPMENTS**

**4. REPORT ON ALGORITHMIC TRADING FOR THE MONTH**

S. No.	Particulars	Data
1	Turnover of Algorithmic Trading (` in crores)	
2	Algorithmic Trading as a percentage of Total trading (%)	
3	Number of stock Brokers / clients using algorithmic trading	
4	Action taken in respect of dysfunctional algos	
5	Status of grievance, if any, received and processed	



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**SECTION V**

**DETAILS OF WAREHOUSING, WAREHOUSING SERVICE PROVIDERS (WSPS), DELIVERIES, HEDGING OPERATIONS & OPEN INTEREST (OI)**

**1. DELIVERY DETAILS**

Name of the Commodity	Physical quantity of delivery	Value of Deliveries	Contract details

**2. TOP 5 HEDGERS DETAILS (COMMODITY-WISE)**

Name of the Commodity	Highest OI	Total Value of Trades	Value of Deliveries	Stocks held in exchange accredited warehouses

**3. TOP 5 OI DETAILS (COMMODITY-WISE)**

Name of the Commodity	Quantity of Highest OI held during the month	Total Value of Trades	Value of Deliveries	Stocks held in exchange accredited warehouses

**4. WAREHOUSE (WH) DETAILS**

Name of the Exchange	Number of the Exchange accredited WH	WDRA registered warehouse	Inspection done	Inspection pending



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## 5. WSP DETAILS

Name of the Exchange	Name of WSPs	Number of warehouses of each WSPs	Name of commodities stored in warehouses	Quantity stored (in MT)	Capacity (in MT)	No. of WDRA registered WH



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**Annexure C**

Criteria for Commodity Eligibility for Derivative Products - Template

**Section I**

<b>Particulars</b>	<b>Weight</b>	<b>Sub-score</b>	<b>Details</b>
<b>Parameter I - Commodity Fundamentals</b>			
Size of commodity			This parameter relates to production, imports, carryover stocks etc...
Volume in cash market			The daily volumes in the underlying cash/spot/physical market may be a good indicator of the depth
Durability and Storability			Relates to the durability and duration for which the commodity can be stored
Homogeneous/ Standardization			Scope for standardization
<b>Parameter I Score</b>			
<b>Parameter II - Ease of doing Business</b>			
<b>Particulars</b>	<b>Weight</b>	<b>Sub-score</b>	<b>Details</b>
Prevalence of price controls			These parameters relates to the ease of doing business in commodity markets. Issues such as price controls, storage controls, Taxation etc., have a bearing on the trade. These parameters are also an indicator of what reforms should be brought in the commodity space in a regulated environment to be best in class globally.
Minimum Support Price (MSP) for the commodity			
Storage controls/ Stock Limits			
Government Policy			
Applicability of other Laws			
<b>Parameter II Score =</b>			



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**Section II**

Particulars	Weight	Sub-score	Details
<b>Parameter III - Trade/ Business</b>			
Global Trade - Imports or Exports			Importance in global trade and to our economy. Ability to add value to the base commodity. Commercial application, nature of buyers, Supply/demand gap etc.
Domestic market / Geographical coverage			
Presence of Value Chain participants (VCPs)			
Supply/ Demand			
<b>Parameter III Score</b>			
<b>Parameter IV - Risk Management</b>			
Particulars	Weight	Sub-score	Details
Correlation			The risk parameters viz., volatility, correlation with either domestic traded prices or globally traded prices, seasonality, liquidity, benefits to hedgers / farmer through direct / indirect participation and scope to hedge the price risk forms part of the Risk Management
Seasonality			
Basis Risk			
Volatility			
Hedging Incentive			
Liquidity			
<b>Parameter IV Score</b>			
<b>Parameter V - Benchmark Potential</b>			
Particulars	Weight	Sub-score	Details
Existence of Forward Trading in OTC markets			
Suitability for Futures/ Options Trading			
Potential to create a Domestic Benchmark			
Potential to create a Global Benchmark			
<b>Parameter V Score</b>			

**Section I Score = Parameter I Score + Parameter II Score**

**Section II Score = Parameter III Score + Parameter IV Score + Parameter V Score**

**Overall Score = Section I Score + Section II Score**

**Note:**

- *Weight-ages in % and total of all weight-ages should be 100*
- *Scores/Sub-scores are to be given in a range of 1 to 5*
- *The following scale is to be used for scoring the parameters:*  
1 : Poor  
2 : Reasonable  
3 : Good  
4 : Very Good  
5 : Excellent



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**Annexure D**

Commodity	Units	Source of Data	Average Deliverable Supply during past five Financial Year				Classification (Board/ Narrow/ Sensitive)	Deliverable Supply during Financial Year			Member Limit*		Client Limit		Overall Exchange wide limit
			Product ion	Impo rt	Total	Total (in Cr)		Product ion	Impo rt	Total	Over all	Near Month	Over all	Near Month	
			In Units												

\* A member's open interest limit at overall (all contracts) level will be either the absolute number indicated above or 15% of the total market wide open position in the commodity, whichever is higher. (As per Clause 5.3 of the SEBI Circular SEBI/HO/CDMRD/DMP/CIR/P/2016/96 dated September 27, 2016)

**Annexure E**

Sr.	Commodity	Unit	Client Level Numerical Position Limit for Overall Commodity
<b>NON-AGRICULTURAL COMMODITIES</b>			
1.	Aluminum	MT	25,000
2.	Brent Crude Oil	BBL	400,000
3.	Copper	MT	7,000
4.	Crude Oil	BBL	480,000
5.	Gold	Kgs	5,000
6.	Lead	MT	3,500
7.	Natural Gas	mmBtu	6,000,000
8.	Nickel	MT	1000
9.	Silver	MT	100
10.	Steel	MT	120,000
11.	Zinc	MT	7,000

## Annexure F

### A. Guidelines for Clubbing of Open Positions:

1. When a person is a partner in one or more partnership firms and /or is a director in one or more companies and/or is a manager(karta) of a Hindu Undivided Family (HUF), the total open position of
  - a. the person as an individual operator,
  - b. the firm or firms in which he is a partner ;
  - c. the Company or companies in which he is a director ; and
  - d. the HUF of which he is a manager(karta)taken together shall not exceed the prescribed limit.
  
2. Where two or more persons are partners in a partnership firm or firms and where two or more persons are director in a company or companies and where two or more persons are Kartas of HUFs, the total open position held by
  - a. all the partners of partnership firm or firms;
  - b. the concerned partnership firm or firms;
  - c. all the directors of the company or companies ;
  - d. the concerned company or companies ;
  - e. all the Kartas of the HUFs ; and
  - f. the concerned HUFstaken together shall not exceed the limit as mentioned above.
  
3. Where a person or persons operating as individuals and /or being partners in one or more partnership firms and/or being directors in one or more companies and/or being kartas of HUFs are also trustees in one or more trusts, the total open position of
  - a. the person as individual operator,
  - b. the firm or firms in which they are partners;
  - c. the company or companies in which they are directors;
  - d. the HUFs in which they are Kartas; and
  - e. the trust or trusts in which they are trustees,taken together shall not exceed the limit as mentioned above.

Provided that, if at any time more deliveries than one are running in the same commodity, the above limit shall apply to the combined open position of the member or the non-member, as the case may be, in all such deliveries running concurrently.

4. Open position of a member shall be the total of the open position acquired by him by trading through or with other member and by appropriating the business of his clients(collectively for all clients).

5. The open position of a non-member shall be the total of the open position acquired by him trading through or with one or more members.

**B. Exemptions from Clubbing:**

1. In the agriculture marketing set up of the rural India, co-operative societies play a crucial role. Primary Agriculture Marketing Societies registered under the state cooperative Acts, thus, are active in different agricultural commodities. These societies are also member of Federations at the State and National level. Due to this Federal structure there may be some instances when these societies have common Directors. Also, the persons from State Governments/RCS may be nominated as Directors in these societies. In view of this, the position of different societies if they are members of a Federation will not be clubbed with the open interest position of the Federation for the purpose of determining the open interest position of the Federal or vice versa. Similarly, if Govt/RCS nominated directors sits on the Boards of different societies, this will not amount to common interest for the purpose of clubbing of positions.
  2. As a practice of good corporate governance, the companies now have independent directors on their Board with no financial interest in the company. Similarly, companies also have Govt/Financial Institutions nominated Directors without any financial interest in the company. In such cases, when the Directors don't have any financial interest in the company. The Commission has taken a view that the position of such companies/corporates may not be clubbed just because they have common directors.
- C.** The above stated guidelines are indicative only. The Exchanges are directed to take suitable measures for clubbing of open positions on the basis of the criteria laid down above and also include other criteria such as PAN, patterns such as 'acting in concert' through common ownership and control structures and any other relevant criteria to club open positions that may be observed during the course of regular monitoring and surveillance that may appear to compromise market integrity.

## Annexure G

### Position Limit Violation

The following penal provisions are made to discourage/ prevent open interest violations at Commodity level / near month contract level-

1. Monetary penalty on the concerned member for violations in the open interest (either on own account or on account of clients) are linked to the quantum/ value of violation committed and to be charged from the concerned member for each such violation as under:
  - a. Where the violation is more than 2% of the prescribed limit(s) –  
Limit exceeded x Closing price x number of days such violation continued x 2% (0.02) or Rs. 10,000/- whichever is higher.
  - b. Where the violation is up to 2% of the prescribed limit(s) –  
Limit exceeded x Closing price x number of days such violation continued x 2% (0.02) or Rs. 10,000/- whichever is lower.
  - c. The member has to ensure reduction in position and to bring it within the prescribed limit(s) by the next trading day after the day of violation. In case such violation continues, the Exchange would square-off the excess position without any further notice to the member by putting the orders on behalf of the member in that client code and will not be responsible for the consequences of such action
2. In case, the instance at 1 (a) above is observed for more than 3 times in a month across the market, the Exchange would suspend the concerned member for a period of one week. For instances at 1 (b) above, the Exchange may devise its norms to deal with habitual defaulters.
3. Further, in case repeated violations of such nature are observed by SEBI, SEBI may consider action against the concerned Exchange.

The monetary penalty as stated above, will be credited to the Investor Protection Fund of the Exchange.

**Annexure H**

<b>Proposed format for dissemination of members data on website</b>	
<b>Sr. No.</b>	<b>Details</b>
1	a) Member Name
	b) Type of Member (TM/TCM/CM/ITCM/STCM)
	c) Constitution of Member (Partnership/Corporate/Proprietor)
2	Address
	a) Registered Office
	b) For Correspondence
3	Exchange Code of the Member
4	SEBI Registration Number
5	Details of all Proprietor/Partner/Directors such as Name, Address, Designation, Email ID, etc.
6	The Link of URL of member's website, if any, should be provided
7	The Compliance Officer and his contact details (Name, Email Id, Phone number, Address, etc.)
8	Name of Authorized Person, Email-ID, Phone number, Address, etc.
9	a) Date of admission to Exchange
	b) Date of commencement of trade by the member
	c) Date of activation (enablement of trading of membership)
10	Branch details to be updated on periodic basis which shall include:
	a) Address
	b) Contact Number
	c) Email-ID
11	Number of clients registered ( to be updated periodically)

**Annexure I**

S. No.	Parameters	Date and Details
1	Commodity	
2	Symbol	
3	Launch Date	
4	Expiry Date	
5	Delivery Logic	
6	Lot Size	
7	Closing price on Launch Date	
8	Total lots traded	
9	Total number of trades	
10	Total trade volume	
11	Total trade value	
12	Daily average volume	
13	Daily average OI	
14	Average volume/ Average OI	
15	Final Settlement Price	
16	Deliveries	
17	Sellers default, if any	
18	Total number of members traded	
19	Total number of client traded	
20	Maximum lots traded in a day	
21	Maximum volume on a single day	
22	Minimum volume on a single day	
23	Maximum trade value on a single day	
24	Minimum trade value on a single day	
25	Maximum open interest at close of any day	
26	Minimum open interest at close of any day	
27	Open interest on expiry date	
28	Highest price on a day	
29	Lowest price on a day	
30	Maximum daily settlement price on a day	
31	Minimum daily settlement price on a day	

## Annexure J

### (i) Liquidity Categorization of Securities

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

Group	Trading Frequency (over the previous six months – see Note A)	Impact Cost (over the previous six months – see Note A)
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

Notes:

A. 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.

### (ii) Computation of VaR Margin

The VaR Margin is a margin intended to cover the largest loss that can be encountered on 99% of the days (99% Value at Risk). For liquid stocks, the margin covers one-day losses while for illiquid stocks, it covers three-day losses so as to allow the clearing corporation to liquidate the position over three days. This leads to a scaling factor of square root of three for illiquid stocks.

For liquid stocks, the VaR margins are based only on the volatility of the stock while for other stocks, the volatility of the market index is also used in the computation. Computation of the VaR margin requires the following definitions:

- **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 in the same manner as in the derivatives market.

- **Scrip VaR** means the higher of 7.5% or 3.5 scrip sigmas.
- **Index sigma** means the daily volatility of the market index (S&P CNX Nifty or BSE Sensex) computed as at the end of the previous trading day. The computation uses the exponentially weighted moving average method applied to daily returns in the same manner as in the derivatives market.
- **Index VaR** means the higher of 5% or 3 index sigmas. The higher of the Sensex VaR or Nifty VaR would be used for this purpose.

The VaR Margins are specified as follows for different groups of stocks:

Liquidity Categorization	One-Day VaR	Scaling factor for illiquidity	VaR Margin
Liquid Securities ( Group I )	Scrip VaR	1.00	Scrip VaR
Less Liquid Securities (Group II)	Higher of Scrip VaR and three times Index VaR	1.73 (square root of 3.00)	Higher of 1.73 times Scrip VaR and 5.20 times Index VaR
Illiquid Securities (Group III)	Five times Index VaR	1.73 (square root of 3.00)	8.66 times Index VaR

## Annexure K

### **Core Settlement Guarantee Fund (Core SGF)**

#### **Objective of Core SGF**

- 1) Clearing Corporation (CC) shall have a fund called Core SGF for each segment of each Recognised Stock Exchange (SE) to guarantee the settlement of trades executed in respective segment of the SE. 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.

#### **Corpus of Core SGF**

- 2) 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. A fixed formula, therefore, cannot be prescribed to estimate the risk or liability of the fund. However, in order to assess the fair quantum of the corpus of Core SGF, 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 guaranteed basis
  - Track record of defaults of members (number of defaults, amount in default)
- 3) However, Minimum Required Corpus of Core SGF (MRC) for each segment of each stock exchange shall be subject to the following:
  - 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. (For example, by 15th February, CC shall determine MRC for March based on results of various stress tests conducted in January). 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 (as per clause 4) for the next month.
  - iii) For every day of the preceding month (i.e., January as per example in (ii) above), uncovered loss numbers shall be estimated by the various stress tests for credit risk conducted by the CC for the segment (as per

- clause 14) and highest of such numbers shall be taken as worst case loss number for the day.
- iv) Average of all the daily worst case loss numbers determined in (iii) above shall be calculated.
  - v) The MRC for next month (i.e., March as per example in (ii) above) shall be higher of the average arrived in at step iv above and the segment MRC as per previous review (i.e., review done on 15th January for the month of February).
  - vi) Minimum threshold value of MRC for commodity derivatives segment of any stock exchange shall be INR 10 Crores.

#### **Contribution to Core SGF**

- 4) At any point of time, the contributions of various contributors to Core SGF of any segment shall be as follows:
- a) Clearing Corporation contribution: CC contribution to Core SGF shall be at least 50% of the MRC. CC shall make this contribution from its own funds. CC contribution to core SGFs shall be considered as part of its net worth.
  - b) Stock Exchange contribution: Stock Exchange contribution to Core SGF shall be at least 25% of the MRC (can be adjusted against transfer of profit by Stock Exchange as per Regulation 33 of SECC Regulations, which may be reviewed in view of these guidelines).
  - c) Clearing Member primary contribution: If the CC wishes, it can seek risk based contribution from Clearing Members (CMs) of the segment (including custodial clearing members) to the Core SGF subject to the following conditions:
    - that total contribution from CMs shall not be more than 25% of the MRC,
    - that no exposure shall be available on Core SGF contribution of any CM (exposure-free collateral of CM available with CC can be considered towards Core SGF contribution of CM), and
    - that required contributions of individual CMs shall be 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.

The above prescribed limits of contribution by CC, SE and CMs may be reviewed by SEBI from time to time considering the prevailing market conditions.

- 5) Any penalties levied by CC (as per Regulation 34 of SECC Regulations) shall be credited to Core SGF corpus.
- 6) 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.
- 7) CC shall ordinarily accept cash collateral for Core SGF contribution. However, CC may accept CM contribution in the form of bank FDs too. CC shall adhere to specific guidance which may be issued by SEBI from time to time in this regard.

### **Management of Core SGF**

- 8) The Defaulter's Committee/SGF utilization Committee of the Clearing Corporation shall manage the Core SGF.

The CCs shall follow prudential norms of Investment policy for Core SGF corpus and establish and implement policies and procedures to ensure that Core SGF corpus is invested in highly liquid financial instruments with minimal market and credit risk and is capable of being liquidated rapidly with minimal adverse price effect.

The instruments in which investments may broadly be made are Fixed Deposit with Banks (only those banks which have a net worth of more than INR 500 Crores and are rated A1 (or A1+) or equivalent, , Treasury Bills, Government Securities and money market/liquid mutual funds subject to suitable transaction/investment limits and monitoring of the same. The CCs shall further ensure that the financial instruments in which the Core SGF corpus is invested remain sufficiently diversified at all times.

SEBI may prescribe the investment norms in this regard from time to time.

### **Access to Core SGF**

- 9) CC may utilise the Core SGF in the event of a failure of member(s) to honour settlement commitment.

### **Further contribution to / Recoupment of Core SGF**

- 10) Requisite contributions to Core SGF by various contributors (as per clauses 3 and 4) 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.

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

### **Review of Core SGF**

11) The monthly review results shall be communicated to the Risk Management Committee and the Governing Board of the Clearing Corporation. The exception reporting shall be made to SEBI detailing the outcome of the review by the CC Governing Board, including steps taken to enhance the Core SGF.

### **Default waterfall**

12) The default waterfall of CC for any segment shall generally follow the following order –

- i. Monies of defaulting member (including defaulting member's primary contribution to Core SGF(s) and excess monies of defaulter in other segments).
- ii. Insurance, if any.
- iii. CC resources (equal to 5% of the segment MRC).
- iv. Core SGF of the segment in the following order:
  - a. Penalties
  - b. CC contribution to the extent of at least 25% of the segment MRC
  - c. Remaining Core SGF: CC contribution, Stock Exchange contribution and non-defaulting members' primary contribution to Core SGF on pro-rata basis.
- v. Proportion of remaining CC resources (excluding CC contribution to core SGFs of other segments and INR 100 Crore) equal to ratio of segment MRC to sum of MRCs of all segments.\*
- vi. 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.
- vii. Capped additional contribution by non-defaulting members of the segment.\*\*
- viii. Any remaining loss to be covered by way of pro-rata haircut to payouts.\*\*\*

\* INR 100 Crore to be excluded only when remaining CC resources (excluding CC contribution to core SGFs of other segments) are more than INR 100 Crore.

\*\*CC shall limit the liability of non-defaulting members towards additional contribution to a multiple of their required primary contribution to Core SGF and the framework regarding the same should be disclosed. In case of shortfall

in recovery of assessed amounts from non-defaulting members, further loss can be allocated to layer 'VI' with approval of SEBI.

\*\*\*In case loss allocation is effected through haircut to payouts, any subsequent usage of funds shall be with prior SEBI approval. Further, any exit by CC post using this layer shall be as per the terms decided by SEBI in public interest.

### **Stress testing and back testing**

- 13)CC shall effectively measure, monitor, and manage its credit exposures to its participants and those arising from its payment, clearing, and settlement processes.
- 14) **Stress test for credit risk:** CC shall carry out daily stress testing for credit risk using at least the standardized stress testing methodology prescribed in para 22 below. Apart from the prescribed stress scenarios , CCs shall also develop own scenarios for a variety of 'extreme but plausible market conditions' (in terms of both defaulters' positions and possible price changes in liquidation periods, including the risk that liquidating such positions could have an impact on the market) and carry out stress testing using self-developed scenarios. Such scenarios should include relevant peak historic price volatilities, shifts in other market factors such as price determinants and yield curves, multiple defaults over various time horizons and a spectrum of forward looking stress scenarios in a variety of extreme but plausible market conditions.
- 15) **Liquidity stress test and adequacy of liquidity arrangements:** CC shall ensure that it maintains sufficient liquid resources to manage liquidity risks from members, settlement banks and those generated by its investment policy. CC shall daily test the adequacy of its liquidity arrangements in order to ensure that its liquid resources are adequate to meet simultaneous default of at least two clearing members and their associates that would generate the largest aggregate liquidity obligation for the CC in extreme but plausible market conditions and compare such obligation with the resources mentioned hereunder:
- a. Cash
  - b. Committed lines of credit available to CC
- 16) **Reverse stress test:** CC shall periodically carry out reverse stress tests designed to identify under which market conditions and under what scenarios the combination of its margins, Core SGF and other financial resources prove insufficient to meet its obligations (e.g. simultaneous default of top N members or N% movement in price of top 2 scrips by turnover or 20% movement in price of top N scrips by turnover etc.)
- 17) **Back testing for adequacy of margins:** CC shall daily conduct back testing of the margins collected vis-à-vis the actual price changes for the contracts

being cleared and settled in every segment to assess appropriateness of its margining models.

- 18) **Adequacy of financial resources:** CC shall ensure that it maintains sufficient financial resources to cover a wide range of potential stress scenarios that should include, but not be limited to, the default of the two participants and their associates that would potentially cause the largest aggregate credit exposure to the CC in extreme but plausible market conditions. Thus, CC shall continuously monitor the adequacy of financial resources (as available in its default waterfall) against the uncovered loss estimated by the various stress tests conducted by the CC and take steps to beef up the same in case of shortfall.
- 19) On at least a monthly basis, CC shall perform a comprehensive and thorough analysis of stress testing scenarios, models, and underlying parameters and assumptions used to ensure they are appropriate for determining the CCP's required level of default protection in light of current and evolving market conditions. CC shall perform this analysis of stress testing more frequently when the products cleared or markets served display high volatility, become less liquid, or when the size or concentration of positions held by a CC's participants increases significantly. A full validation of CC's risk-management model shall be performed at least annually.
- 20) The results of tests carried out as per clauses 14, 15, 16, 17 and 18 above and review conducted as per clause 19 shall be monitored by the Risk Management Committee of the CC and the same should be communicated for discussion and review by the Board of the CC.
- 21) Clearing corporations and Stock Exchanges are directed to make the following details available on its website:
  - i. Policy on composition and contributions to be made to the Core SGF;
  - ii. Investment policy for Core SGF;
  - iii. Default waterfall for each segment along with the quantum of resources available in each layer of default waterfall;

### **Standardized Stress Testing for Commodity Derivatives**

#### **Part A. Scenarios**

##### **Historical Scenarios**

###### **1 Peak Historical Return**

Price movement in respect of each underlying over the MPOR period during the last 15 years to be considered:

**Scenario 1A:** Maximum percentage rise over MPOR period

**Scenario 1B:** Maximum percentage fall over MPOR period

## **2 Peak historical price volatility**

Historical price volatility (EWMA volatility) in respect of each commodity during the previous 15 years is to be considered. Percentage price movement equal to 3.5 times the peak historical volatility adjusted for applicable MPOR period of the commodity shall be considered (subject to a maximum of 110% of the price movement considered for the commodity under the peak historical return scenario):

**Scenario 2A:** Percentage price rise

**Scenario 2B:** Percentage price fall

## **2 Augmented historical**

Exchange shall identify top 10 days during the previous 15 years based on average of absolute percentage price change across all commodities witnessed over the MPOR period. For each of the day, exchange shall identify percentage price change in each commodity (in case of unavailability of prices in any of the commodity on any of the identified days, price change equal to applicable initial margin in the commodity to be considered). All the price movements to be scaled up by 10%.

Thus, one scenario corresponding to each of the 10 identified days shall be generated.

## **Hypothetical scenarios**

### **4 Stressed MPOR**

It shall be assumed that liquidation of open positions would require 5 days and percentage price movement equal to 3.5 times current volatility adjusted for 5 day period (i.e., scaling up by square root of 5) shall be considered.

**Scenario 4A:** Percentage rise over 5 day period

**Scenario 4B:** Percentage fall over 5 day period

### **5 Stressed PSR and VSR**

Price movement in respect of each underlying to the extent of 1.5 times the normal price scan range (PSR) over the MPOR period and change in implied volatility equal to 1.5 times the normal volatility scan range shall be considered.

**Scenario 5A:** Underlying price increasing by 1.5 PSR adjusted for MPOR period, volatility increasing by 1.5 VSR.

**Scenario 5B:** Underlying price decreasing by 1.5 PSR adjusted for MPOR period, volatility increasing by 1.5 VSR.

**Exchanges shall carry out stress tests using each of the scenarios given in Part A as follows –**

- a. By stressing positions in all commodities simultaneously
- b. By first identifying top 10 commodities based on OI and stressing 1 commodity at a time (ignoring positions in other commodities and the corresponding margins)

#### **Part B. Methodology**

The percentage price movements identified in each of the above scenarios shall be applied to the commodity price on the day for which the stress test is being done. All open positions shall be assumed to be squared up at the theoretical price corresponding to the revised prices/volatility of the underlying in each of the scenarios. For each clearing member, the credit exposure to Clearing Corporation shall be calculated as follows:

- a) The time of stress test shall be end of day
- b) It shall be assumed that clearing member will default in paying the settlement obligations and all outstanding positions will be squared off at the theoretical price corresponding to the revised price/volatility of the underlying in the scenario.
- c) Loss shall be calculated at client portfolio level.
- d) For each client, residual loss shall be equal to → (loss due to close-out of client positions– margin supporting that specific client's positions)
- e) All residual losses (residual profits to be ignored) for all clients shall be grossed to compute total residual losses due to client positions.
- f) Loss due to close-out of proprietary positions shall be considered.
- g) Loss at (e) and loss at (f) and the net pay-in/pay-out requirement of the clearing member shall be assessed against required margins (excluding margin supporting client positions and excess collateral, if any) and other mandatory deposits of defaulting member to calculate credit exposure of Clearing Corporation to the member. Equity scrips as collateral, if any, shall be valued with minimum 20% haircut.

#### **Part C. Coverage**

To begin with, for each of the scenarios in Part A, Clearing Corporations shall calculate –

- A. Credit exposure due to simultaneous default of at least 2 clearing members (and their associates) causing highest credit exposure.

- B. 25% of the credit exposure due to simultaneous default of all clearing members.

However, within a year from the deadline of implementation of the circular, for each of the scenarios in Part A, Clearing Corporations shall calculate –

- A. Credit exposure due to simultaneous default of at least 2 clearing members (and their associates) causing highest credit exposure.
- B. 50% of the credit exposure due to simultaneous default of all clearing members.

**Annexure L**

<b>Serial Number</b>	<b>Items/ Issues to be examined and Reported</b>	<b>Compliance/Comments</b>
1	<p><b>GENERAL:-</b>  Justification for introducing of futures/forward trading in the commodity including its relevance /importance to the economy (in brief) <b>with information for preceding 3 financial years on :-</b></p>	
a.	Its annual production	
b.	Import-export data	
c.	Details of domestic consumption	
d.	Main area of cultivation	
e.	Patterns of consumption/utilization	
f.	Commercialization rate (annual exports/annual supply)	
g.	Crop cycle	
h.	Warehouse facilities in the cultivation area	
i.	Preferred trade quantity in physical market	
j.	Shelf-life of the commodity	
k.	Global level production / consumption figures, major exporting & importing countries with figures	
l.	Monthly price movement in futures market – both domestic and international for last 3 years	
m.	Prevailing spot prices in the domestic physical market in the last three years and immediate 3 preceding months prior to the application	
n.	Which are the other exchanges where the proposed contract is already being traded and its/ their respective market share in terms of volumes & percentage of trades (estimated)?	
o.	Value Chain of the commodity	
p.	Degree of standardisation	
q.	Political sensitivity/price controls	



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Serial Number	Items/ Issues to be examined and Reported	Compliance/Comments
r.	Whether commodity is under purview of Essential commodities act / APMC Act / The Food Control Regulation Act etc.	
s.	Geographical coverage	
t.	Correlation with International Market	
u.	Seasonality	
v.	Price Volatility	
2	<b>CONTRACT DESIGN- Please Specify with Reasons</b>	
a.	Lot size	
b.	Tick size	
c.	Period of the contract (one month, two months, etc.)	
d.	Quality standards (should meet FSSAI standards and any other statutory prescribed standards )	
e.	Lean period	
f.	Basis Centers	
g.	Mechanism for allocation of delivery on the Exchange platform in a transparent manner	
h.	Rationale behind adopting “intention matching contract” as against “compulsory delivery” contract, if the case is so, in the proposed contract.	
i.	Mechanism of spot price polling –whether AGMARK prices used to track spot prices- other measures/precautions taken to ensure transparency and credibility	
j.	Settlement system with settlement price formula	
3.	<b>EXPECTED PARTICIPATION IN THE CONTRACT</b>	
a.	Hedgers participation	
b.	Warehouse participation	



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<b>Serial Number</b>	<b>Items/ Issues to be examined and Reported</b>	<b>Compliance/Comments</b>
c.	What efforts Exchange had made to educate hedgers / market participants about the contract	
4.	<b>COST OF TRADING IN CONTRACT :-</b>	
a.	Details of Delivery Centers, their respective storage capacity, and price neutralization formula for non-preferred delivery centers etc.	
b.	Detailed break-up of charges proposed to be levied by the Exchanges for trading / warehouse for storage / delivery charges and cost in respect of failed deliveries, etc.	
5.	<b>MARKET SURVEILLANCE AND RISK MANAGEMENT :-</b>	
a.	Permitted price variation in a day	
b.	Open position limits in respect of client, member and market as a whole	
c.	Checks and balances for high frequency/ Algo trades	
d.	Initial margin, M -o-M margin, and conditions under which special / additional margins could be levied by Exchanges	
e.	Settlement / trade guarantee	
f.	Cost of failed payments / deliveries	
g.	Staggered delivery system	
<b>Additional Information required in case of proposal for renewal of existing/earlier contracts</b>		
6.	<b>THE TRACK RECORD OF TRADING IN THE CONTRACT LIKE :-</b>	
a.	Trading volume	
b.	Open interest	
c.	Deliveries	
d.	Market participation	
e.	Price movement	
f.	Trade versus delivery	
g.	Order versus actual trade	

<b>Serial Number</b>	<b>Items/ Issues to be examined and Reported</b>	<b>Compliance/Comments</b>
h.	Average trade size at Exchange	
i.	Actual production versus actual delivery through exchange trading platform	
j.	Preferred lot size in physical market	
k.	Justification for introduction	
l.	Whether the contract is traded on other exchanges?	
m.	Justification for span of the contract	
n.	Any abnormal trade activity / price movements in previous year	
o.	The educational initiatives taken by the Exchanges for the market participants and` feedback received from them	
p.	Efforts taken to create/encourage formation of Aggregators for participation in the contract on behalf of Farmers/planters	
7.	Status of quarterly progress reports submitted to the regulator.	
8.	Status of awareness programmes for Hedgers/Potential Hedgers/Industry Associations / processors etc. organised during last 1 year.	
9.	Any other information considered relevant	
10.	<b>ANY OTHER COMMENTS/ EXPLANATIONS TO OFFER, IF ANY (IN BRIEF)</b>	



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**Annexure M**

<b>Exchange Name</b>	<b>Contracts approved for continuous trading</b>
Multi Commodity Exchange of India Ltd.	Aluminium, Aluminium Mini, Brent Crude Oil, Cardamom, Copper, Copper Mini, Cotton, Crude Palm Oil, Crude Oil, Dhaniya, Gold, Gold Guinea, Gold Mini, Gold Petal, Gold Petal Delhi, Lead, Lead Mini, Mentha Oil, Natural Gas, Nickel, Nickel Mini, Silver, Silver1000, Silver Mini, Silver Micro, Zinc, Zinc Mini
National Commodity & Derivatives Exchange Ltd.	Barley, Chilli, Copper Cathode, Cottonseed Oil Cake, Crude Oil, Crude Palm Oil, Dhaniya, Gold Hedge, Guar Gum, Guar Seed (2 MT), Guar Seed (10 MT), Jeera, V-797 Kapas, Maize (Kharif), Maize (Rabi), Rape/Mustard Seed, Refined Soy Oil, Shankar Kapas, Soyabean, Steel Long, Sugar M, Turmeric, Wheat
National Multi Commodity Exchange of India Ltd.	Cardamom, Castor Seed, Coffee Rep Bulk, Isabgulseed, Copra, Pepper, Rape/Mustard Seed, Raw Jute, Rubber, Sacking, Soy Oil, Guar Seed



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**Annexure N**

**Disposal of Arbitration Proceedings (where client is a party) initiated since April 1, 2010 (Updated on mm dd yyyy)**  
**(To be updated quarterly, within a week of end of the quarter)**

Arbitration Reference No.	Date of Reference	Region	Name of Client	Name of Member	Name of Arbitrator(s)	Date of Arbitral award	Award in favour of (client/ Member)	Copy of Award (link given below)	Date of Implementation of Award	Main reason for non-implementation
<b>Initiated during 2010-11</b>										
<b>Initiated during 2011-12</b>										



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**Annexure O**

**Arbitrator-wise Arbitration Proceedings (where client is a party) disposed of since April 1, 2010 Updated on mm dd yyyy (In excel sheet) (To be updated quarterly, within a week of the end of the quarter)**

S. No.	Name of Arbitrator	No. of awards passed	No. of Awards in favor of Clients of the cases filed by		No. of Appellate Awards in favor of Clients of the cases filed by		Clients of the cases filed by Arbitration cases pending for .... months			Arbitration appeal cases pending for			
		Arbitration	Appellate	Member	Client	Member	Client	<4	≥4 - ≤ 6	>6	<3	≥3- ≤ 6	>6
N													
Total													

(In case of panel of arbitrators, the cases / awards would appear against every member of the panel) (Arrange the arbitrators in descending number of awards passed by them during the period)



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**Annexure P**

**Disclosure of Arbitration and Appellate Arbitration Awards Passed since April 1, 2007 Updated on mm dd yyyy (In excel sheet) (To be updated as soon as a new award is issued)**

Sl. No.	Date of Issue	Name of Client	Name of Member	Initial Arbitration / Appellate Arbitration	Link to Award given below
<b>Passed during 2007-08</b>					
<b>Passed during 2008-09</b>					
<b>Passed during 2009-10</b>					
<b>Passed during 2010-11</b>					
<b>Passed during 2011-12</b>					

## Annexure Q

### **Stock Broker System Audit Framework**

#### **Audit Process**

1. System Audit of stock brokers should be conducted with the following periodicity
  - a. Annual system audit is prescribed for stock brokers who satisfy any of the following criteria.
    - i. Stock Brokers who use **[Computer-to-Computer Link (CTCL) or Intermediate Messaging Layer (IML)] / Internet Based Trading (IBT)/ Direct Market Access (DMA)/ Securities Trading using Wireless Technology (STWT) / Smart Order Routing (SOR)** and have presence in more than 10 locations or number of terminals are more than 50.
    - ii. Stock Brokers who are depository participants or are involved in offering any other financial services.
  - b. Half yearly system audit has been prescribed for stock brokers who use Algorithmic Trading or provide their clients with the facility of Algorithmic Trading as per SEBI Circular CIR/MRD/16/2013 dated May 21, 2013.
  - c. For all other stock brokers, system audit shall be conducted once in two years.
2. Such audit shall be conducted in accordance with the Norms, Terms of Reference (ToR) and Guidelines issued by SEBI and / or by stock exchanges. Separate ToRs are specified for the following categories of brokers:
  - a. **Type I Broker:** Brokers who trade through exchange provided terminals such as NSE's NEAT, BSE's BOLT, MCX-SX's TWS, etc. (ToR attached as **Annexure 1**);
  - b. **Type II Broker:** Brokers who trade through API based trading terminals like [CTCL or IML] or IBT/DMA/STWT or SOR facility and who may also be TYPE I Brokers. (ToR attached as **Annexure 2**)
  - c. **Type III Broker:** Brokers who use Algorithmic Trading facility to trade and who may also be TYPE II Brokers. (ToR attached as **Annexure 3**)
3. Stock brokers shall select auditors as per the selection norms provided in the guidelines and directions issued by stock exchanges and SEBI from time to time. The Auditor may perform a maximum of 3 successive audits of the stock broker.
4. The stock exchanges shall periodically review ToR of such system audit and, if required, shall suitably revise the ToR after taking into consideration developments that have taken place in the securities market since the last

review of ToR, observations reported in the audit reports of the stock brokers and directions issued by SEBI from time to time in this regard.

5. The auditor in its report shall specify compliance / non-compliance status with regard to areas mentioned in ToR. Observations on minor / major deviations as well as qualitative comments for scope for improvement shall also be specified in the report. The auditor shall also take into consideration the observations / issues mentioned in the previous audit reports and cover open items in the report. The audit report submitted by the auditor should be forwarded to the stock exchange by the Stock Broker along with management comments, within 1 month of submission of report by the auditor.
6. Stock exchange shall ensure that the management of the stock broker provides their comment about the non-compliance / non-conformities (NCs) and observations mentioned in the report. For each NC, specific time-bound (within 3 months of submission of report by the exchange) corrective action must be taken and reported to the stock exchange. The auditor should indicate if a follow-on audit is required to review the status of NCs.
7. In order to ensure that the corrective actions are taken by the stock broker, follow-on audit, if any, shall be scheduled by the stock broker within 6 months of submission of the audit report by the system auditor.
8. The system auditors should follow the reporting standard as specified in **Annexure-4** of this Framework for the executive summary of the System Audit report to highlight the major findings of the System Audit.

#### **Auditor Selection Norms**

1. The Auditor shall have minimum 3 years of experience in IT audit of securities market participants e.g. stock exchanges, clearing corporations, depositories, stock brokers, depository participants etc. The audit experience should cover all the major areas mentioned under Terms of Reference (ToR) of the system audit specified by SEBI / stock exchange.
2. It is recommended that resources employed shall have relevant industry recognized certifications e.g. D.I.S.A. (ICAI) Qualification , CISA (Certified Information System Auditor) from ISACA, CISM (Certified Information Securities Manager) from ISACA, CISSP (Certified Information Systems Security Professional) from International Information Systems Security Certification Consortium, commonly known as (ISC).
3. The Auditor should have experience of IT audit/governance frameworks and processes conforming to industry leading practices like CobiT.
4. The Auditor shall not have any conflict of interest in conducting fair, objective and independent audit of the Stock Broker. Further, the directors / partners of

Auditor firm shall not be related to any stock broker including its directors or promoters either directly or indirectly.

The Auditor shall not have any cases pending against its previous audited companies/firms, which fall under SEBI's jurisdiction, which point to its incompetence and/or unsuitability to perform the audit task.

### **Annexure 1**

#### **Terms of Reference (ToR) for Type I Broker**

The system auditor shall at the minimum cover the following areas:

##### **1. System controls and capabilities**

- a. **Order Tracking** – The system auditor should verify system process and controls at exchange provided terminals with regard to order entry, capturing of IP address of order entry terminals, modification / deletion of orders, status of the current order/outstanding orders and trade confirmation.
- b. **Order Status/ Capture** – Whether the system has capability to generate / capture order id, time stamping, order type, scrip details, action, quantity, price and validity etc.
- c. **Rejection of orders** – Whether system has capability to reject orders which do not go through order level validation at the end of the stock broker and at the servers of respective stock exchanges.
- d. **Communication of Trade Confirmation / Order Status** – Whether the system has capability to timely communicate to Client regarding the Acceptance/ Rejection of an Order / Trade via various media including e-mail; facility of viewing trade log.
- e. **Client ID Verification** – Whether the system has capability to recognize only authorized Client Orders and mapping of Specific user Ids to specific predefined location for proprietary orders.

##### **2. Risk Management System (RMS)**

- a. **Online risk management capability** – The system auditor should check whether the system of online risk management (including upfront real-time risk management) is in place for all orders placed through exchange provided terminals.
- b. **Trading Limits** –Whether a system of 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 RMS are allowed to be pushed into exchange trading engines. The system auditor should check that no user or branch in the system is having unlimited limits on the above parameters.

- c. **Order Alerts and Reports** –Whether the system has capability to generate alerts when orders that are placed are above the limits and has capability to generate reports relating to Margin Requirements, payments and delivery obligations.
- d. **Order Review** –Whether the system has capability to facilitate review of such orders were not validated by the system.
- e. **Back testing for effectiveness of RMS** – Whether the system has capability to identify trades which have exceeded the pre-defined limits (Order Quantity and Value Limits, Symbol wise User Order / Quantity limit, User / Branch Order Limit, Order Price limit) and also exceed corresponding margin availability of clients. Whether deviations from such pre-defined limits are captured by the system, documented and corrective steps taken.
- f. **Log Management** – Whether the system maintains logs of alerts / changes / deletion / activation / deactivation of client codes and logs of changes to the risk management parameters mentioned above. Whether the system allows only authorized users to set the risk parameter in the RMS.

### 3. Password Security

- a. **Organization Access Policy** – Whether the organization has a well-documented policy that provides for a password policy as well as access control policy for the exchange provided terminals.
- b. **Authentication Capability** – Whether the system authenticates user credentials by means of a password before allowing the user to login, and whether there is a system for authentication of orders originating from Internet Protocol by means of two-factor authentication, including Public Key Infrastructure (PKI) based implementation of digital signatures.
- c. **Password Best Practices** – Whether there is a system provision for masking of password, system prompt to change default password on first login, disablement of user id on entering multiple wrong passwords (as defined in the password policy document), periodic password change mandate and appropriate prompt to user, strong parameters for password, deactivation of dormant user id, etc.

### 4. Session Management

- a. **Session Authentication** – Whether the system has provision for Confidentiality, Integrity and Availability (CIA) of the session and the data

transmitted during the session by means of appropriate user and session authentication mechanisms like SSL etc.

- b. **Session Security** – Whether there is availability of an end-to-end encryption for all data exchanged between client and broker systems. or other means of ensuring session security
- c. **Inactive Session** – Whether the system allows for automatic trading session logout after a system defined period of inactivity.
- d. **Log Management** – Whether the system generates and maintain logs of Number of users, activity logs, system logs, Number of active clients.

## 5. Network Integrity

- a. **Seamless connectivity** – Whether stock broker has ensured that a backup network link is available in case of primary link failure with the exchange.
- b. **Network Architecture** – Whether the web server is separate from the Application and Database Server.
- c. **Firewall Configuration** – Whether appropriate firewall is present between stock broker's trading setup and various communication links to the exchange. Whether the firewall is appropriately configured to ensure maximum security.

## 6. Access Controls

- a. **Access to server rooms** – Whether adequate controls are in place for access to server rooms and proper audit trails are maintained for the same.
- b. **Additional Access controls** – Whether the system provides for any authentication mechanism to access to various components of the exchange provided terminals. Whether additional password requirements are set for critical features of the system. Whether the access control is adequate.

## 7. Backup and Recovery

- a. **Backup and Recovery Policy** – Whether the organization has a well-documented policy on periodic backup of data generated from the broking operations.
- b. **Log generation and data consistency** - Whether backup logs are maintained and backup data is tested for consistency.
- c. **System Redundancy** – Whether there are appropriate backups in case of failures of any critical system components.

**8. BCP/DR** (Only applicable for Stock Brokers having BCP / DR site)

- a. **BCP / DR Policy** – Whether the stock broker has a well-documented BCP/ DR policy and plan. The system auditor should comment on the documented incident response procedures.
- b. **Alternate channel of communication** – Whether the stock broker has provided its clients with alternate means of communication including channel for communication in case of a disaster. Whether the alternate channel is capable of authenticating the user after asking for additional details or OTP (One-Time-Password).
- c. **High Availability** – Whether BCP / DR systems and network connectivity provide high availability and have no single point of failure for any critical operations as identified by the BCP/DR policy.
- d. **Connectivity with other FMIs** – The system auditor should check whether there is an alternative medium to communicate with Stock Exchanges and other FMIs.

**9. Segregation of Data and Processing facilities** – The system auditor should check and comment on the segregation of data and processing facilities at the Stock Broker in case the stock broker is also running other business.

**10. Back office data**

- a. **Data consistency** – The system auditor should verify whether aggregate client code data available at the back office of broker matches with the data submitted / available with the stock exchanges through online data view / download provided by exchanges to members.
- b. **Trail Logs** – The system auditor should specifically comment on the logs of Client Code data to ascertain whether editing or deletion of records have been properly documented and recorded and does not result in any irregularities.

**11. IT Infrastructure Management** ( including use of various Cloud computing models such as Infrastructure as a service (IaaS), Platform as a service (PaaS), Software as a service (SaaS), Network as a service (NaaS) )

- a. **IT Governance and Policy** – The system auditor should verify whether the relevant IT Infrastructure-related policies and standards exist and are regularly reviewed and updated. Compliance with these policies is periodically assessed.
- b. **IT Infrastructure Planning** – The system auditor should verify whether the plans/policy for the appropriate management and replacement of aging IT infrastructure components have been documented, approved, and implemented. The activities, schedules and resources needed to achieve objectives related to IT infrastructure have been integrated into business plans and budgets.

- c. **IT Infrastructure Availability (SLA Parameters)** – The system auditor should verify whether the broking firm has a process in place to define its required availability of the IT infrastructure, and its tolerance to outages. In cases where there is huge reliance on vendors for the provision of IT services to the brokerage firm the system auditor should also verify that the mean time to recovery (MTTR) mentioned in the Service Level Agreement (SLA) by the service provider satisfies the requirements of the broking firm.
- d. **IT Performance Monitoring (SLA Monitoring)** – The system auditor should verify that the results of SLA performance monitoring are documented and are reported to the management of the broker.

**12. Exchange specific exceptional reports** – The additional checks recommended by a particular exchange need to be looked into and commented upon by the system auditor over and above the ToR of the system audit.

**Annexure 2**  
**ToR for Type II Broker**

The system auditor shall at the minimum cover the following areas:

- 1. System controls and capabilities (CTCL / IML terminals and servers)**
  - a. **Order Tracking** – The system auditor should verify system process and controls at CTCL / IML terminals and CTCL/ IML servers covering order entry, capturing of IP address of order entry terminals, modification / deletion of orders, status of current order/outstanding orders and trade confirmation.
  - b. **Order Status/ Capture** – Whether the system has capability to generate / capture order id, time stamping, order type, scrip details, action, quantity, price and validity, etc.
  - c. **Rejection of orders** – Whether system has capability to reject orders which do not go through order level validation at CTCL servers and at the servers of respective stock exchanges.
  - d. **Communication of Trade Confirmation / Order Status** – Whether the system has capability to timely communicate to Client regarding the Acceptance/ Rejection of an Order / Trade via various media including e-mail; facility of viewing trade log.
  - e. **Client ID Verification** – Whether the system has capability to recognize only authorized Client Orders and mapping of Specific user Ids to specific predefined location for proprietary orders.
  - f. **Order type distinguishing capability** – Whether system has capability to distinguish the orders originating from (CTCL or IML) / IBT/ DMA / STWT.
- 2. Software Change Management** - The system auditor should check whether proper procedures have been followed and proper documentation has been maintained for the following:
  - a. Processing / approval methodology of new feature request or patches
  - b. Fault reporting / tracking mechanism and process for resolution
  - c. Testing of new releases / patches / modified software / bug fixes
  - d. Version control- History, Change Management process, approval etc.
  - e. Development / Test / Production environment segregation.
  - f. New release in production – promotion, release note approvals
  - g. Production issues / disruptions reported during last year, reasons for such disruptions and corrective actions taken.
  - h. User Awareness

The system auditor should check whether critical changes made to the (CTCL or IML) / IBT / DMA / STWT/ SOR are well documented and communicated to the Stock Exchange.

### 3. Risk Management System (RMS)

- a. **Online risk management capability** – The system auditor should check whether system of online risk management including upfront real-time risk management, is in place for all orders placed through (CTCL or IML) / IBT / DMA / STWT.
  - b. **Trading Limits** – Whether a system of 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 RMS are allowed to be pushed into exchange trading engines. The system auditor should check that no user or branch in the system is having unlimited limits on the above parameters.
  - c. **Order Alerts and Reports** – Whether the system has capability to generate alerts when orders that are placed are above the limits and has capability to generate reports relating to margin requirements, payments and delivery obligations.
  - d. **Order Review** – Whether the system has capability to facilitate review of such orders that were not validated by the system.
  - e. **Back testing for effectiveness of RMS** – Whether system has capability to identify trades which have exceeded the pre-defined limits (Order Quantity and Value Limits, Symbol wise User Order / Quantity limit, User / Branch Order Limit, Order Price limit) and also exceed corresponding margin availability of clients. Whether deviations from such pre-defined limits are captured by the system, documented and corrective steps taken.
  - f. **Log Management** – Whether the system maintains logs of alerts / changes / deletion / activation / deactivation of client codes and logs of changes to the risk management parameters mentioned above. Whether the system allows only authorized users to set the risk parameter in the RMS.
4. **Smart order routing (SOR)** - The system auditor should check whether proper procedures have been followed and proper documentation has been maintained for the following:
    - a. **Best Execution Policy** – System adheres to the Best Execution Policy while routing the orders to the exchange.
    - b. **Destination Neutral** – The system routes orders to the recognized stock exchanges in a neutral manner.

- c. **Class Neutral** – The system provides for SOR for all classes of investors.
- d. **Confidentiality** - The system does not release orders to venues other than the recognized stock Exchange.
- e. **Opt-out** – The system provides functionality to the client who has availed of the SOR facility, to specify for individual orders for which the clients do not want to route order using SOR.
- f. **Time stamped market information** – The system is capable of receiving time stamped market prices from recognized stock Exchanges from which the member is authorized to avail SOR facility.
- g. **Audit Trail** - Audit trail for SOR should capture order details, trades and data points used as a basis for routing decision.
- h. **Server Location** – The system auditor should check whether the order routing server is located in India.
- i. **Alternate Mode** - The system auditor should check whether an alternative mode of trading is available in case of failure of SOR Facility

## 5. Password Security

- a. **Organization Access Policy** – Whether organization has a well-documented policy that provides for a password policy as well as access control policy for exchange provided terminals and for API based terminals.
- b. **Authentication Capability** – Whether the system authenticates user credentials by means of a password before allowing the user to login, and whether there is a system for authentication of orders originating from Internet Protocol by means of two-factor authentication, including Public Key Infrastructure (PKI) based implementation of digital signatures.
- c. **Password Best Practices** – Whether there is a system provision for masking of password, system prompt to change default password on first login, disablement of user id on entering multiple wrong passwords (as defined in the password policy document), periodic password change mandate and appropriate prompt to user, strong parameters for password, deactivation of dormant user id, etc.

## 6. Session Management

- a. **Session Authentication** – Whether system has provision for Confidentiality, Integrity and Availability (CIA) of the session and the data transmitted during the session by means of appropriate user and session authentication mechanisms like SSL etc.

- b. **Session Security** – Whether there is availability of an end-to-end encryption for all data exchanged between client and broker systems or other means of ensuring session security. Whether session login details are stored on the devices used for IBT and STWT.
- c. **Inactive Session** – Whether the system allows for automatic trading session logout after a system defined period of inactivity.
- d. **Log Management** – Whether the system generates and maintains logs of Number of users, activity logs, system logs, Number of active clients.

## 7. Database Security

- a. **Access** – Whether the system allows CTCL or IML database access only to authorized users / applications.
- b. **Controls** – Whether the CTCL or IML database server is hosted on a secure platform, with Username and password stored in an encrypted form using strong encryption algorithms.

## 8. Network Integrity

- a. **Seamless connectivity** – Whether the stock broker has ensured that a backup network link is available in case of primary link failure with the exchange.
- b. **Network Architecture** – Whether the web server is separate from the Application and Database Server.
- c. **Firewall Configuration** – Whether appropriate firewall is present between stock broker's trading setup and various communication links to the exchange. Whether the firewall is appropriately configured to ensure maximum security.

## 9. Access Controls

- a. **Access to server rooms** – Whether adequate controls are in place for access to server rooms and proper audit trails are maintained for the same.
- b. **Additional Access controls** – Whether the system provides for two factor authentication mechanism to access to various CTCL or IML components. Whether additional password requirements are set for critical features of the system. Whether the access control is adequate.

## 10. Backup and Recovery

- a. **Backup and Recovery Policy** – Whether the organization has a well-documented policy on periodic backup of data generated from the broking operations.

- b. **Log generation and data consistency** - Whether backup logs are maintained and backup data is tested for consistency
- c. **System Redundancy** – Whether there are appropriate backups in case of failures of any critical system components

#### **11. BCP/DR** (Only applicable for Stock Brokers having BCP / DR site)

- a. **BCP / DR Policy** – Whether the stock broker has a well-documented BCP/ DR policy and plan. The system auditor should comment on the documented incident response procedures.
- b. **Alternate channel of communication** – Whether the stock broker has provided its clients with alternate means of communication including channel for communication in case of a disaster. Whether the alternate channel is capable of authenticating the user after asking for additional details or OTP (One-Time-Password).
- c. **High Availability** – Whether BCP / DR systems and network connectivity provide high availability and have no single point of failure for any critical operations as identified by the BCP/ DR policy.
- d. **Connectivity with other FMIs** – The system auditor should check whether there is an alternative medium to communicate with Stock Exchanges and other FMIs.

#### **12. Segregation of Data and Processing facilities** – The system auditor should check and comment on the segregation of data and processing facilities at the Stock Broker in case the stock broker is also running other business.

#### **13. Back office data**

- a. **Data consistency** – The system auditor should verify whether aggregate client code data available at the back office of broker matches with the data submitted / available with the stock exchanges through online data view / download provided by exchanges to members.
- b. **Trail Logs** – The system auditor should specifically comment on the logs of Client Code data to ascertain whether editing or deletion of records have been properly documented and recorded and does not result in any irregularities.

#### **14. User Management**

- a. **User Management Policy** – The system auditor should check whether the stock broker has a well-documented policy that provides for user management and the user management policy explicitly defines user, database and application Access Matrix.
- b. **Access to Authorized users** – The system auditor should check whether the system allows access only to the authorized users of the CTCL or IML System. Whether there is a proper documentation of the

authorized users in the form of User Application approval, copies of User Qualification and other necessary documents.

- c. **User Creation / Deletion** – The system auditor should check whether new users' ids were created / deleted as per CTCL or IML guidelines of the exchanges and whether the user ids are unique in nature.
- d. **User Disablement** – The system auditor should check whether non-complaint users are disabled and appropriate logs (such as event log and trade logs of the user) are maintained.

**15. IT Infrastructure Management** ( including use of various Cloud computing models such as Infrastructure as a service (IaaS), Platform as a service (PaaS), Software as a service (SaaS), Network as a service (NaaS) )

- a. **IT Governance and Policy** – The system auditor should verify whether the relevant IT Infrastructure-related policies and standards exist and are regularly reviewed and updated. Compliance with these policies is periodically assessed.
- b. **IT Infrastructure Planning** – The system auditor should verify whether the plans/policy for the appropriate management and replacement of aging IT infrastructure components have been documented, approved, and implemented. The activities, schedules and resources needed to achieve objectives related to IT infrastructure have been integrated into business plans and budgets.
- c. **IT Infrastructure Availability (SLA Parameters)** – The system auditor should verify whether the broking firm has a process in place to define its required availability of the IT infrastructure, and its tolerance to outages. In cases where there is huge reliance on vendors for the provision of IT services to the brokerage firm the system auditor should also verify that the mean time to recovery (MTTR) mentioned in the Service Level Agreement (SLA) by the service provider satisfies the requirements of the broking firm.
- d. **IT Performance Monitoring (SLA Monitoring)** – The system auditor should verify that the results of SLA performance monitoring are documented and are reported to the management of the broker.

**16. Exchange specific exceptional reports** – The additional checks recommended by a particular exchange need to be looked into and commented upon by the System Auditor over and above the ToR of the System audit.

**17. Software Testing Procedures** - The system auditor should check whether the stock broker has complied with the guidelines and instructions of SEBI / stock exchanges with regard to testing of software and new patches, including the following:

- a. **Test Procedure Review** – The system auditor should evaluate whether the procedures for system and software testing were proper and adequate.
- b. **Documentation** – The system auditor should verify whether the documentation related to testing procedures, test data, and resulting output were adequate and follow the organization's standards.
- c. **Test Cases** – The system auditor should review the internal test cases and comment upon the adequacy of the same with respect to the requirements of the Stock Exchange and SEBI.

**Annexure 3**  
**ToR for Type III Broker**

The system auditor shall at the minimum cover the following areas:

- 1. System controls and capabilities (CTCL/IML Terminals and servers)**
  - a. **Order Tracking** – The system auditor should verify system process and controls at CTCL / IML terminals and CTCL/ IML servers covering order entry, capturing IP address of order entry, modification / deletion of orders, status of current order/outstanding orders and trade confirmation.
  - b. **Order Status/ Capture** – Whether the system has capability to generate / capture order id, time stamping, order type, scrip details, action, quantity, price and validity etc.
  - c. **Rejection of orders** – Whether the system has capability to reject orders which do not go through order level validation at CTCL servers and at the servers of respective exchanges.
  - d. **Communication of Trade Confirmation / Order Status** – Whether the system has capability to timely communicate to client regarding the Acceptance/ Rejection of an Order / Trade via various media including e-mail; facility of viewing trade log.
  - e. **Client ID Verification** – Whether the system has capability to recognize only authorized Client Orders and mapping of Specific user Ids to specific predefined location for proprietary orders.
  - f. **Order type distinguishing capability** – Whether the system has capability to distinguish the orders originating from (CTCL or IML) / IBT / DMA / STWT / SOR / Algorithmic Trading.
- 2. Software Change Management** - The system auditor should check whether proper procedures have been followed and proper documentation has been maintained for the following:
  - a. Processing/approval methodology of new feature request or patches
  - b. Fault reporting / tracking mechanism and process for resolution
  - c. Testing of new releases / patches / bug fixes
  - d. Version control- History, Change Management process, approval etc.
  - e. Development / Test/ Production environment segregation.
  - f. New release in production – promotion, release note approvals
  - g. Production issues/ disruptions reported during last year, reasons for such disruptions and corrective actions taken.
  - h. User Awareness

The System Auditor should check whether critical changes made to the (CTCL or IML) / IBT / DMA / STWT / SOR are well documented and communicated to the Stock Exchange.

### **3. Risk Management System (RMS)**

- a. **Online risk management capability** – The system auditor should check whether the online risk management including upfront real-time risk management, is in place for all orders placed through (CTCL or IML) / IBT/ DMA / SOR / STWT / Algorithmic Trading.
  - b. **Trading Limits** – Whether a system of 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 RMS are allowed to be pushed into exchange trading engines. The system auditor should check that no user or branch in the system is having unlimited limits on the above parameters.
  - c. **Order Alerts and Reports** – Whether the system has capability to generate alerts when orders that are placed are above the limits and has capability to generate reports relating to margin requirements, payments and delivery obligations.
  - d. **Order Review** – Whether the system has capability to facilitate review of such orders that were not validated by the system.
  - e. **Back testing for effectiveness of RMS** – Whether the system has capability to identify trades which have exceeded the pre-defined limits (Order Quantity and Value Limits, Symbol wise User Order / Quantity limit, User / Branch Order Limit, Order Price limit) and also exceed corresponding margin availability of clients. Whether deviations from such pre-defined limits should be captured by the system, documented and corrective steps taken.
  - f. **Log Management** – Whether the system maintains logs of alerts / changes / deletion / activation / deactivation of client codes and logs of changes to the risk management parameters mentioned above. Whether the system allows only authorized users to set the risk parameter in the RMS.
4. **Smart order routing (SOR)** - The system auditor should check whether proper procedures have been followed and proper documentation has been maintained for the following:
    - a. **Best Execution Policy** – System adheres to the Best Execution Policy while routing the orders to the exchange.
    - b. **Destination Neutral** – The system routes orders to the recognized stock exchanges in a neutral manner.

- c. **Class Neutral** – The system provides for SOR for all classes of investors.
  - d. **Confidentiality** - The system does not release orders to venues other than the recognized stock Exchange.
  - e. **Opt-out** – The system provides functionality to the client who has availed of the SOR facility, to specify for individual orders for which the clients do not want to route order using SOR.
  - f. **Time stamped market information** – The system is capable of receiving time stamped market prices from recognized stock Exchanges from which the member is authorized to avail SOR facility.
  - g. **Audit Trail** - Audit trail for SOR should capture order details, trades and data points used as a basis for routing decision.
  - h. **Server Location** – The system auditor should check whether the order routing server is located in India.
  - i. **Alternate Mode** - The system auditor should check whether an alternative mode of trading is available in case of failure of SOR Facility
5. **Algorithmic Trading** - The system auditor should check whether proper procedures have been followed and proper documentation has been maintained for the following:
- a. **Change Management** – Whether any changes (modification/addition) to the approved algos were informed to and approved by stock exchange. The inclusion / removal of different versions of algos should be well documented.
  - b. **Online Risk Management capability**- The CTCL or IML server should have capacity to monitor orders / trades routed through algo trading and have online risk management for all orders through Algorithmic trading and ensure that Price Check, Quantity Check, Order Value Check, Cumulative Open Order Value Check are in place.
  - c. **Risk Parameters Controls** – The system should allow only authorized users to set the risk parameter. The System should also maintain a log of all the risk parameter changes made.
  - d. **Information / Data Feed** – The auditor should comment on the various sources of information / data for the algo and on the likely impact (run away /loop situation) of the failure one or more sources to provide timely feed to the algorithm. The system auditor should verify that the algo automatically stops further processing in the absence of data feed.
  - e. **Check for preventing loop or runaway situations** – The system auditor should check whether the brokers have real time monitoring systems to identify and shutdown/stop the algorithms which have not behaved as expected.

- f. **Algo / Co-location facility Sub-letting** – The system auditor should verify if the algo / co-location facility has not been sub-let to any other firms to access the exchange platform.
- g. **Audit Trail** – The system auditor should check the following areas in audit trail:
  - i. Whether the audit trails can be established using unique identification for all algorithmic orders and comment on the same.
  - ii. Whether the broker maintains logs of all trading activities.
  - iii. Whether the records of control parameters, orders, traders and data emanating from trades executed through algorithmic trading are preserved/ maintained by the Stock Broker.
  - iv. Whether changes to the control parameters have been made by authorized users as per the Access Matrix. The system auditor should specifically comment on the reasons and frequency for changing of such control parameters. Further, the system auditor should also comment on the possibility of such tweaking leading to run away/loop situation.
  - v. Whether the system captures the IP address from where the algo orders are originating.
- h. **Systems and Procedures** – The system auditor should check and comment on the procedures, systems and technical capabilities of stock broker for carrying out trading through use of Algorithms. The system auditor should also identify any misuse or unauthorized access to algorithms or the system which runs these algorithms.
- i. **Reporting to Stock Exchanges** – The system auditor should check whether the stock broker is informing the stock exchange regarding any incidents where the algos have not behaved as expected. The system auditor should also comment upon the time taken by the stock broker to inform the stock exchanges regarding such incidents.

## 6. Password Security

- a. **Organization Access Policy** – The system auditor should whether the stock broker has a well-documented policy that provides for a password policy as well as access control policy for exchange provided terminals and for API based terminals.
- b. **Authentication Capability** – Whether the system authenticates user credentials by means of a password before allowing the user to login. Whether there is a system for authentication of orders originating from Internet Protocol by means of two-factor authentication, including Public Key Infrastructure (PKI) based implementation of digital signatures.
- c. **Password Best Practices** – Whether there is a system should for masking of password, system prompt to change default password on first

login, disablement of user id on entering multiple wrong passwords (as defined in the password policy document), periodic password change mandate and appropriate prompt to user, strong parameters for password, deactivation of dormant user id, etc.

## 7. Session Management

- a. **Session Authentication** – Whether the system has provision for Confidentiality, Integrity and Availability (CIA) of the session and the data transmitted during the session by means of appropriate user and session authentication mechanisms like SSL etc.
- b. **Session Security** – Whether there is availability of an end-to-end encryption for all data exchanged between client and broker system or other means of ensuring session security. Whether session login details are stored on the devices used for IBT and STWT.
- c. **Inactive Session** – Whether the system allows for automatic trading session logout after a system defined period of inactivity.
- d. **Log Management** – Whether the system generates and maintains logs of number of users, activity logs, system logs, number of active clients.

## 8. Database Security

- a. **Access** – Whether the system allows CTCL or IML database access only to authorized users / applications.
- b. **Controls** – Whether the CTCL or IML database server is hosted on a secure platform, with username and password stored in an encrypted form using strong encryption algorithms.

## 9. Network Integrity

- a. **Seamless connectivity** – Whether the stock broker has ensured that a backup network link is available in case of primary link failure with the exchange.
- b. **Network Architecture** – Whether the web server is separate from the Application and Database Server.
- c. **Firewall Configuration** – Whether appropriate firewall are present between the stock broker's trading setup and various communication links to the exchange. Whether the firewalls should be appropriately configured to ensure maximum security.

## 10. Access Controls

- a. **Access to server rooms** – Whether adequate controls are in place for access to server rooms, proper audit trails should be maintained for the same.

- b. **Additional Access controls** - Whether the system should provide for two factor authentication mechanism to access to various CTCL or IML components. Whether additional password requirements are set for critical features of the system. Whether the access control is adequate.

## 11. Backup and Recovery

- a. **Backup and Recovery Policy** – Whether the organization has a well-documented policy on periodic backup of data generated from the broking operations.
- b. **Log generation and data consistency** – Whether backup logs are maintained and backup data should be tested for consistency.
- c. **System Redundancy** – Whether there are appropriate backups in case of failures of any critical system components.

## 12. BCP/DR (Only applicable for Stock Brokers having BCP / DR site)

- a. **BCP / DR Policy** – Whether the stock broker has a well-documented BCP / DR policy and plan. The system auditor should comment on the documented incident response procedures.
- b. **Alternate channel of communication** – Whether the stock broker has provided its clients with alternative means of communication including channel for communication in case of a disaster. Whether the alternate channel is capable of authenticating the user after asking for additional details or OTP (One-Time-Password).
- c. **High Availability** – Whether BCP / DR systems and network connectivity provide high availability and have no single point of failure for any critical operations as identified by the BCP / DR policy.
- d. **Connectivity with other FMIs** – The system auditor should check whether there is an alternative medium to communicate with Stock Exchanges and other FMIs.

## 13. Segregation of Data and Processing facilities

– The system auditor should check and comment on the segregation of data and processing facilities at the Stock Broker in case the stock broker is also running other business.

## 14. Back office data

- a. **Data consistency** – The system auditor should verify whether aggregate client code data available at the back office of broker matches with the data submitted / available with the stock exchanges through online data view / download provided by exchanges to members.
- b. **Trail Logs** – The system auditor should specifically comment on the logs of Client Code data to ascertain whether editing or deletion of records have been properly documented and recorded and does not result in any irregularities.

## 15. User Management

- a. **User Management Policy** – The system auditor should verify whether the stock broker has a well-documented policy that provides for user management and the user management policy explicitly defines user, database and application access matrix.
- b. **Access to Authorized users** – The system auditor should verify whether the system allows access only to the authorized users of the CTCL or IML system. Whether there is a proper documentation of the authorized users in the form of user application approval, copies of user qualification and other necessary documents.
- c. **User Creation / Deletion** – The system auditor should verify whether new user's ids should be created / deleted as per CTCL or IML guidelines of the exchanges and whether the user ids are unique in nature.
- d. **User Disablement** – The system auditor should verify whether non-complaint users are disabled and appropriate logs such as event log and trade logs of the user should be maintained

## 16. IT Infrastructure Management ( including use of various Cloud computing models such as Infrastructure as a service (IaaS), Platform as a service (PaaS), Software as a service (SaaS), Network as a service (NaaS) )

- a. **IT Governance and Policy** – The system auditor should verify whether the relevant IT Infrastructure-related policies and standards exist and are regularly reviewed and updated. Compliance with these policies is periodically assessed.
- b. **IT Infrastructure Planning** – The system auditor should verify whether the plans/policy for the appropriate management and replacement of aging IT infrastructure components have been documented, approved, and implemented. The activities, schedules and resources needed to achieve objectives related to IT infrastructure have been integrated into business plans and budgets.
- c. **IT Infrastructure Availability (SLA Parameters)** – The system auditor should verify whether the broking firm has a process in place to define its required availability of the IT infrastructure, and its tolerance to outages. In cases where there is huge reliance on vendors for the provision of IT services to the brokerage firm the system auditor should also verify that the mean time to recovery (MTTR) mentioned in the Service Level Agreement (SLA) by the service provider satisfies the requirements of the broking firm.
- d. **IT Performance Monitoring (SLA Monitoring)** – The system auditor should verify that the results of SLA performance monitoring are documented and are reported to the management of the broker.

- 17. Exchange specific exceptional reports** – The additional checks recommended by a particular exchange need to be looked into and commented upon by the system auditor over and above the ToR of the system audit.
- 18. Software Testing Procedures** - The system auditor shall audit whether the stock broker has complied with the guidelines and instructions of SEBI / stock exchanges with regard to testing of software and new patches including the following:
- a. **Test Procedure Review** – The system auditor should review and evaluate the procedures for system and program testing. The system auditor should also review the adequacy of tests.
  - b. **Documentation** – The system auditor should review documented testing procedures, test data, and resulting output to determine if they are comprehensive and if they follow the organization's standards.
  - c. **Test Cases** – The system auditor should review the test cases and comment upon the adequacy of the same with respect to the requirements of the Stock Exchange and various SEBI Circulars.



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Annexure -4  
Executive Summary Reporting Format

**I. For Preliminary Audit**

Audit Date	Observation No	Description of Finding	Department	Status / Nature of Findings	Risk Rating of Findings	Audit TOR Clause	Audit ed By	Root Cause Analysis	Impact Analysis	Suggested Corrective Action	Deadline for the Corrective Action	Verified By	Closing Date

**Description of relevant Table heads**

- 1. Audit Date** – This indicates the date of conducting the audit.
- 2. Description of Findings/ Observations** – Description of the findings in sufficient detail, referencing any accompanying evidence (e.g. copies of procedures, interview notes, screen shots etc.)
- 3. Status/ Nature of Findings** - the category can be specified for example:
  - Non-Compliant
  - Work In progress
  - Observation
  - Suggestion
- 4. Risk Rating of Findings** – A rating has to be given for each of the observations based on their impact and severity to reflect the risk exposure, as well as the suggested priority for action.



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<b>Rating</b>	<b>Description</b>
<b>HIGH</b>	Weakness in control those represent exposure to the organization or risks that could lead to instances of noncompliance with the requirements of TORs. These risks need to be addressed with utmost priority.
<b>MEDIUM</b>	Potential weakness in controls, which could develop into an exposure or issues that represent areas of concern and may impact internal controls. These should be addressed reasonably promptly.
<b>LOW</b>	Potential weaknesses in controls, which in combination with other weakness can develop into an exposure. Suggested improvements for situations not immediately/directly affecting controls.

5. Audit TOR Clause – The TOR clause corresponding to this observation
6. Root cause Analysis –A detailed analysis on the cause of the nonconformity
7. Impact Analysis – An analysis of the likely impact on the operations/ activity of the organization
8. Suggested Corrective Action –The action to be taken by the broker to correct the nonconformity

**II. For Follow on / Follow up System Audit**

Preliminary Audit Date	Sr. No	Preliminary Observation Number	Preliminary Status	Preliminary Corrective Action	Current Finding	Current Status	Revised Corrective Action	Deadline for the Revised Corrective Action	Verified By	Closing Date



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#### Description of relevant Table heads

1. **Preliminary Status** – The original finding as per the preliminary System Audit Report
2. **Preliminary Corrective Action** – The original corrective action as prescribed in the preliminary System Audit report
3. **Current Finding** – The current finding w.r.t. the issue
4. **Current Status** – Current status of the issue viz Compliant, Non-Compliant, Work In Progress (WIP)
5. **Revised Corrective Action** – The revised corrective action prescribed w.r.t. the Non-Compliant / WIP issues

## Annexure R

### Cyber Security and Cyber Resilience framework

1. Cyber-attacks and threats attempt to compromise the Confidentiality, Integrity and Availability (CIA) of the computer systems, networks and databases.\* Cyber security framework include measures, tools and processes that are intended to prevent cyber-attacks and improve cyber resilience. Cyber Resilience is an organization's ability to prepare and respond to a cyber-attack and to continue operation during, and recover from, a cyber-attack.

\*Confidentiality refers to limiting access of systems and information to authorized users, Integrity is the assurance that the information is reliable and accurate, and Availability refers to guarantee of reliable access to the systems and information by authorized users

### Governance

2. As part of the operational risk management framework to manage risk to systems, networks and databases from cyber-attacks and threats , MII should formulate a comprehensive cyber security and cyber resilience policy document encompassing the framework mentioned hereunder. The policy document should be approved by the Board, and in case of deviations from the suggested framework, reasons for such deviations should also be provided in the policy document. The policy document should be reviewed by the MII's Board at least annually with the view to strengthen and improve its cyber security and cyber resilience framework.
3. The cyber security and cyber resilience policy should include the following process to identify, assess, and manage cyber security risk associated with processes, information, networks and systems.
  - a. 'Identify' critical IT assets and risks associated with such assets,
  - b. 'Protect' assets by deploying suitable controls, tools and measures,
  - c. 'Detect' incidents, anomalies and attacks through appropriate monitoring tools / processes,
  - d. 'Respond' by taking immediate steps after identification of the incident, anomaly or attack,
  - e. 'Recover' from incident through incident management, disaster recovery and business continuity framework.
4. The Cyber security policy should encompass the principles prescribed by National Critical Information Infrastructure Protection Centre (NCIIPC) of National Technical Research Organization (NTRO), Government of India in the report titled 'Guidelines for Protection of National Critical Information Infrastructure' and subsequent revisions, if any, from time to time.

5. MII should also incorporate best practices from standards such as ISO 27001, ISO 27002, COBIT 5, etc., or their subsequent revisions, if any, from time to time.
6. MII should designate a senior official as Chief Information Security Officer (CISO) whose function would be to assess, identify and reduce cyber security risks, respond to incidents, establish appropriate standards and controls, and direct the establishment and implementation of processes and procedures as per the cyber security and resilience policy approved by the Board of the MII.
7. The Oversight Standing Committee on Technology of the stock exchanges and of the clearing corporations should on a quarterly basis review the implementation of the cyber security and resilience policy approved by their Boards, and such review should include review of their current IT and cyber security and resilience capabilities, set goals for a target level of cyber resilience, and establish a plan to improve and strengthen cyber security and cyber resilience
8. MII should establish a reporting procedure to facilitate communication of unusual activities and events to CISO or to the senior management in a timely manner.
9. The aforementioned committee and the senior management of the MII, including the CISO, should periodically review instances of cyber-attacks, if any, domestically and globally, and take steps to strengthen cyber security and cyber resilience framework.
10. MII should define responsibilities of its employees, outsourced staff, and employees of vendors, members or participants and other entities, who may have access or use systems / networks of MII, towards ensuring the goal of cyber security.

### **Identity**

11. MII should identify critical assets based on their sensitivity and criticality for business operations, services and data management. To this end, MII should maintain up-to-date inventory of its hardware and systems, software and information assets (internal and external), details of its network resources, connections to its network and data flows.
12. MII should accordingly identify cyber risks (threats and vulnerabilities) that it may face, along with the likelihood of such threats and impact on the business and thereby, deploy controls commensurate to the criticality.
13. MII should identify critical assets based on their sensitivity and criticality for business operations, services and data management. To this end, MII

should maintain up-to-date inventory of its hardware and systems, software and information Security.

## **Protection**

### Access Controls

14. No person by virtue of rank or position should have any intrinsic right to access confidential data, applications, system resources or facilities.
15. Any access to MII's systems, applications, networks, databases, etc., should be for a defined purpose and for a defined period. MII should grant access to IT systems, applications, databases and networks on a need-to-use basis and based on the principle of least privilege .Such access should be for the period when the access is required and should be authorized using strong authentication mechanisms.
16. MII should implement strong password controls for users' access to systems, applications, networks and databases. Password controls should include a change of password upon first log -on, minimum password length and history, password complexity as well as maximum validity period. The user credential data should be stored using strong and latest hashing algorithms.
17. MII should ensure that records of user access are uniquely identified and logged for audit and review purposes. Such logs should be maintained and stored in encrypted form for a time period not less than two (2) years.
18. MII should deploy additional controls and security measures to supervise staff with elevated system access entitlements (such as admin or privileged users). Such controls and measures should inter-alia include restricting the number of privileged users, periodic review of privileged users' activities, disallow privileged users from accessing systems logs in which their activities are being captured, strong controls over remote access by privileged users, etc.
19. Account access lock policies after failure attempts should be implemented for all accounts.
20. Employees and outsourced staff such as employees of vendors or service providers, who may be given authorized access to the MII's critical systems, networks and other computer resources, should be subject to stringent supervision, monitoring and access restrictions.
21. Two-factor authentication at *log-in* should be implemented for all users that connect using online / internet facility.



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22. MII should formulate an Internet access policy to monitor and regulate the use of internet and internet based services such as social media sites, cloud-based internet storage sites, etc.
23. Proper 'end of life' mechanism should be adopted to deactivate access privileges of users who are leaving the organization or who access privileges have been withdrawn.

### Physical security

24. Physical access to the critical systems should be restricted to minimum. Physical access of outsourced staff / visitors should be properly supervised by ensuring at the minimum that outsourced staff / visitors are accompanied at all times by authorized employees.
25. Physical access to the critical systems should be revoked immediately if the same is no longer required.
26. MII should ensure that the perimeter of the critical equipments room are physically secured and monitored by employing physical, human and procedural controls such as the use of security guards, CCTVs, card access systems, mantraps, bollards, etc. where appropriate.

### Network Security Management

27. MII should establish baseline standards to facilitate consistent application of security configurations to operating systems, databases, network devices and enterprise mobile devices within the IT environment. The MII should conduct regular enforcement checks to ensure that the baseline standards are applied uniformly.
28. MII should install network security devices, such as firewalls as well as intrusion detection and prevention systems, to protect its IT infrastructure from security exposures originating from internal and external sources.
29. Anti-virus software should be installed on servers and other computer systems. Updation of Anti-virus definition files and automatic anti-virus scanning should be done on a regular basis.

### Security of Data

30. Data-in motion and Data-at-rest should be in encrypted form by using strong encryption methods such as Advanced Encryption Standard (AES), RSA, SHA-2, etc.
31. MII should implement measures to prevent unauthorized access or copying or transmission of data / information held in contractual or fiduciary capacity. It should be ensured that confidentiality of information is not compromised during the process of exchanging and transferring information with external parties.
32. The information security policy should also cover use of devices such as mobile phone, faxes, photocopiers, scanners, etc. that can be used for capturing and transmission of data.
33. MII should allow only authorized data storage devices through appropriate validation processes.

#### Hardening of Hardware and Software

34. Only a hardened and vetted hardware / software should be deployed by the MII. During the hardening process, MII should inter-alia ensure that default passwords are replaced with strong passwords and all unnecessary services are removed or disabled in equipments / software.
35. All open ports which are not in use or can potentially be used for exploitation of data should be blocked. Other open ports should be monitored and appropriate measures should be taken to secure the ports.

#### Application Security and Testing

36. MII should ensure that regression testing is undertaken before new or modified system is implemented. The scope of tests should cover business logic, security controls and system performance under various stress-load scenarios and recovery conditions.

#### Patch Management

37. MII should establish and ensure that the patch management procedures include the identification, categorization and prioritization of security patches. An implementation timeframe for each category of security patches should be established to implement security patches in a timely manner.
38. MII should perform rigorous testing of security patches before deployment into the production environment so as to ensure that the application of patches do not impact other systems.

#### Disposal of systems and storage devices

39. MII should frame suitable policy for disposals of the storage media and systems. The data / information on such devices and systems should be removed by using methods viz. wiping / cleaning / overwrite, degauss and physical destruction, as applicable.

#### Vulnerability Assessment and Penetration Testing (VAPT)

40. MII should regularly conduct vulnerability assessment to detect security vulnerabilities in the IT environment. MII should also carry out periodic penetration tests, at least once in a year, in order to conduct an in-depth evaluation of the security posture of the system through simulations of actual attacks on its systems and networks.

41. Remedial actions should be immediately taken to address gaps that are identified during vulnerability assessment and penetration testing.

42. In addition, MII should perform vulnerability scanning and conduct penetration testing prior to the commissioning of a new system which offers internet accessibility and open network interfaces.

#### **Monitoring and Detection**

43. MII should establish appropriate security monitoring systems and processes to facilitate continuous monitoring of security events and timely detection of unauthorized or malicious activities, unauthorized changes, unauthorized access and unauthorized copying or transmission of data / information held in contractual or fiduciary capacity, by internal and external parties. The security logs of systems, applications and network devices should also be monitored for anomalies.

44. Further, to ensure high resilience, high availability and timely detection of attacks on systems and networks, MII should implement suitable mechanism to monitor capacity utilization of its critical systems and networks.

45. Suitable alerts should be generated in the event of detection of unauthorized or abnormal system activities, transmission errors or unusual online transactions.

#### **Response and Recovery**

46. Alerts generated from monitoring and detection systems should be suitably investigated, including impact and forensic analysis of such alerts, in order to determine activities that are to be performed to prevent expansion of such incident of cyber-attack or breach, mitigate its effect and eradicate the incident.

47. The response and recovery plan of the MII should aim at timely restoration of systems affected by incidents of cyber-attacks or breaches. The recovery plan

should be in line with the Recovery Time Objective (RTO) and Recovery Point Objective (RPO) specified by SEBI.

48. The response plan should define responsibilities and actions to be performed by its employees and support / outsourced staff in the event of cyber-attacks or breach of cyber security mechanism.
49. Any incident of loss or destruction of data or systems should be thoroughly analyzed and lessons learned from such incidents should be incorporated to strengthen the security mechanism and improve recovery planning and processes.
50. MII should also conduct suitable periodic drills to test the adequacy and effectiveness of response and recovery plan.

### **Sharing of information**

51. Quarterly reports containing information on cyber-attacks and threats experienced by MII and measures taken to mitigate vulnerabilities, threats and attacks including information on bugs / vulnerabilities / threats that may be useful for other MIIs, should be submitted to SEBI.
52. Such details as are felt useful for sharing with other MIIs in masked and anonymous manner shall be shared using mechanism to be specified by SEBI from time to time.

### **Training**

53. MII should conduct periodic training programs to enhance awareness level among the employees and outsourced staff, vendors, etc. on IT / Cyber security policy and standards. Special focus should be given to build awareness levels and skills of staff from non-technical disciplines.
54. The training program should be reviewed and updated to ensure that the contents of the program remain current and relevant.

### **Periodic Audit**

55. The Terms of Reference for the System Audit of national commodities derivatives exchange shall be accordingly modified to include audit of implementation of the aforementioned areas.

### List of Circulars

S. No.	Date	Title
1.	Oct 01, 2015	Comprehensive Risk Management Framework for National Commodity Derivatives Exchanges
2.	Oct 21, 2015	Risk Management for Regional Commodity Derivatives Exchanges
3.	Nov 16, 2015	Investor grievance redressal system and arbitration mechanism
4.	Nov 16, 2015	Annual System Audit and BCP DR
5.	Nov 26, 2015	Timelines for Compliance with various provisions of Securities Laws by Commodity Derivatives Exchanges
6.	Dec 09, 2015	Monthly Development Report for Commodity Derivative Exchanges
7.	Dec 11, 2015	Testing of software used in or related to Trading and Risk Management
8.	Jan 11, 2016	Mandatory requirements/Exit Policy for Commodity Derivatives Exchanges
9.	Jan 15, 2016	Reduction in Daily Price Limits & Near month Position Limits for Agricultural Commodity Derivatives and Suspension of Forward Segment
10.	Jan 29, 2016	Revision in Position Limits for Agricultural Commodities
11.	Mar 29, 2016	Modification of Client Codes post Execution of Trades on National and Regional Commodity Derivatives Exchanges
12.	Mar 29, 2016	Cyber Security and Cyber Resilience framework of National Commodity Derivatives Exchanges
13.	Apr 25, 2016	Disclosure of Proprietary Trading by Commodity Derivatives Broker to Client and Pro - account Trading terminal
14.	Aug 11, 2016	Annual System Audit for Trading members of National Commodity Derivatives Exchanges
15.	Aug 19, 2016	Programmes sponsored by the Exchanges through media channels
16.	Aug 19, 2016	Position Limits for Hedgers
17.	Aug 19, 2016	Modification of Client Codes post Execution of Trades on National and Regional Commodity Derivatives Exchanges – Clarification
18.	Aug 30, 2016	Trading Hours/ Trading Holidays on Commodity Derivatives Exchanges
19.	Aug 30, 2016	Price Dissemination through SMS/Electronic Communication Facility

S. No.	Date	Title
20.	Aug 30, 2016	Maintenance and Preservation of Records
21.	Sep 01, 2016	Additional risk management norms for national commodity derivatives exchanges
22.	Sep 02, 2016	Spot Price Polling Mechanism
23.	Sep 07, 2016	Transaction Charges by Commodity Derivatives Exchanges
24.	Sep 07, 2016	Mechanism for regular monitoring of and penalty for short-collection/non-collection of margins from clients
25.	Sep 07, 2016	Daily Price Limits (DPL) for Non-Agricultural Commodity Derivatives/First day DPL for All Commodity Derivatives
26.	Sep 07, 2016	Guidelines for Due Date Rate (DDR) fixation for Regional Commodity Derivatives Exchanges
27.	Sep 16, 2016	Unique Client Code (UCC) and Mandatory requirement of Permanent Account Number (PAN)
28.	Sep 16, 2016	Settlement Guarantee Fund, Stress Testing and Base Minimum Capital
29.	Sep 20, 2016	Permission for trading in futures contracts and modification in contract specifications at exchange level
30.	Sep 21, 2016	Staggered delivery, early delivery system, early pay-in facility, penalty on delivery default, fixation of FSP and changes in expiry dates
31.	Sep 26, 2016	Commodity derivatives – Miscellaneous norms
32.	Sep 26, 2016	Circular on Investor Protection Fund (IPF) and its related matters
33.	Sep 27, 2016	Revised Warehousing Norms in the Commodity Derivatives Market for Agricultural and Agri-processed Commodities Traded on the National Commodity Derivatives Exchanges
34.	Sep 27, 2016	Position Limits for Commodity Derivatives, clubbing of open positions, penalties for violation of position limits
35.	Sep 27, 2016	Portfolio Management Services (PMS) in Commodity Derivatives Market
36.	Sep 27, 2016	Sharing of Information in case of Declaration of Member as Defaulter in case of Multiple Membership
37.	Sep 27, 2016	Disclosure by Commodity Derivative Exchanges on their Websites
38.	Sep 27, 2016	Broad Guidelines on Algorithmic Trading for National Commodity Derivatives Exchanges
39.	Sep 28, 2016	List of Commodities Notified under SCRA
40.	Sep 28, 2016	Introduction of Options in Commodity Derivatives Market

S. No.	Date	Title
41.	Oct 14, 2016	Bullion as collateral
42.	Dec 02, 2016	Spread margin benefit
43.	Dec 16, 2016	Applicability of Principles of Financial Market Infrastructures (PFMIs) on Commodity Derivatives Exchanges
44.	Jan 20, 2017	Criteria for Eligibility, Retention and re-introduction of derivative contracts on Commodities
45.	Jun 13, 2017	Options on Commodity Futures- Product Design and Risk Management Framework
46.	Jun 13, 2017	Comprehensive guidelines for Investor protection Fund, Investor Service Fund and its related matters
47.	Jun 21, 2017	Participation of Category III Alternative Investment Funds (AIFs) in the commodity derivatives market
48.	Jul 11, 2017	Amendment to Investor Grievance Redressal System and Arbitration Mechanism
49.	Jul 25, 2017	Position Limits for Agricultural Commodity Derivatives
50.	Oct 16, 2017	Criteria for Settlement Mode of Commodity Derivative Contracts
51.	Jan 03, 2018	Transaction Charges by Commodity Derivatives Exchanges
52.	Mar 14, 2018	Clarification to Circular pertaining to Investor Protection Fund (IPF) and Investor Service Fund (ISF)
53.	Mar 14, 2018	Clarification to Circular pertaining to Investor Grievance Redressal System and Arbitration Mechanism
54.	Mar 20, 2018	Spread margin benefit in commodity futures contracts
55.	Mar 21, 2018	Risk Management norms for commodity derivatives
56.	Mar 26, 2018	Guidelines for Liquidity Enhancement Schemes (LES) in Commodity Derivatives Contracts
57.	Apr 03, 2018	Orders per second limit and requirement of empanelment of system auditors for algorithmic trading in commodity derivatives
58.	Jun 11, 2018	Disclosure by Exchanges related to Deliverable Supply and Position Limits Calculation for Agricultural Commodity Derivatives
59.	Jul 11, 2018	Core SGF and standardized stress testing for credit risk for commodity derivatives