

PROPOSED POLICY FOR IMPROVEMENT IN SALES PRACTICE BY THE MEMBERS OF THE STOCK EXCHANGES

Introduction

SEBI has received suggestions for further improvement in sales practices followed by the trading members of the Stock Exchanges. It is observed that the code of conduct mentioned in the SEBI (Stock-brokers and Sub-brokers) Regulations, 1992 as well as the bye laws/circulars/rules/regulations of the exchanges lay down guidelines in respect of sales practices.

The matter was discussed with the Stock exchanges. It is felt that there is a need to enhance the regulatory framework and also to create a sense of awareness among investors in this regard. Accordingly, based on the suggestions received from exchanges, it is proposed that brokers adopt the guidelines prescribed below:

1. Strengthening KYC Norms

- a) The Exposure/Turnover limit given by the trading members should be commensurate with the financial details of the clients reported in the KYC. The said limit to be specified in the KYC and strictly adhered to or the details in KYC to be suitably modified.
- b) Only person with financial standing at least comparable to that of the client he is introducing should be accepted as introducer. The documents such as PAN Card, Income Tax Return / Proof of residence etc to be maintained alongwith the KYC of the client to whom he is introducing.

2. Work history & background of the Trading Member

- a) Trading Members may be required to inform the clients (upfront at the time of entering into Member-Client agreement) about work history & background of their firm.
- b) Actions against the trading member for non-compliance/breach of regulatory requirements, investor grievances & arbitration cases filed, pending etc. may be disclosed.

3. Sales practices

- a) Trading members owe their clients a duty to provide suitable investment advice in the best interest of the clients. The basis of sales efforts should reasonably represent fair treatment for the persons towards whom the sales efforts are directed.
- b) While recommending purchase or sale of any security / derivatives contract to a client, trading member shall have reasonable grounds for believing that the recommendation is suitable for such client on the basis of the facts disclosed by such client as to his / her financial position, other security holdings, past investment experience & pattern and investment needs.

- c) Prior to the execution of transactions on behalf of a non-institutional client, trading member shall make reasonable efforts to obtain the following information regarding the client
 - Financial status
 - Investment objectives
 - Past investment experience & pattern
 - Risk appetite of the client.
 - Such other information considered to be reasonable by the trading member
- d) Trading members shall not recommend to any client any transactions unless they have reasonable grounds for believing that the entire recommended transaction is not unsuitable for the client, based on the information provided by the client and after reasonable enquiry by the trading member.
- e) Trading members shall ensure that the client is adequately informed of the nature and the implication of the recommended transactions and the facts or circumstances which the client needs to know in order to make informed purchase or sale decision.
- f) Trading members shall also assure themselves that the client understands the risks involved in such orders and has sufficient networth to be able to assume the risks and bear the potential losses if such orders result in trades.
- g) Trading members shall not recommend to their clients securities or derivative contracts on such securities in a concentrated manner, which represents a subjective or arbitrary supply of information.
- h) Trading members shall also ensure timely execution of such transactions of their clients so as to ensure best available price for the client.

4. Excessive trading activity

- a) Trading members shall not encourage or induce excessive trading or speculative activity in a client's account which is not in accordance with the objectives, risk appetite and financial situation of the client involved.

5. Fair dealing with customers with regard to derivative products or new financial products

- a) Trading members shall ensure fair dealing with customers when making recommendations or accepting orders for derivatives contracts and new financial products.
- b) As new products are introduced from time to time, it is imperative that trading members make every effort to familiarize themselves with each

customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding such products.

- c) The clients may be required to have certain minimum amount of net-worth (e.g.5 lacs) for trading in Derivative Segment. A net-worth certificate from a practicing Chartered Accountant or acknowledgement for I.T. return filed should be accepted in this regard.
- d) While registering any client for Derivative Segment, apart from signing a Risk Disclosure Document, the trading member also should ensure that adequate training vis-à-vis risk associated (including margin requirement) with Derivative Segment is imparted to the clients.

6. Conflicts of interest

- a) Trading members must maintain Chinese wall among its various activities such as proprietary trading, investment banking, research etc.
- b) No trading member may directly or indirectly offer favorable research or a specific price target to a company as consideration or inducement for the receipt of business or compensation.
- c) Trading members shall ensure that no research analyst may purchase or sell any security issued by a company that the research analyst follows or derivative of such security, for a period beginning 30 calendar days before and five calendar days after the publication of a research report concerning the company.
- d) Trading member shall ensure that no research analyst may purchase or sell any security or derivative of such security in a manner inconsistent with the research analyst's recommendation as reflected in the most recent research report published by the member.
- e) A member must disclose in research reports and a research analyst of the trading member must disclose in public appearances:
 - (a) if the research analyst or a member of the research analyst's household has a financial interest in the securities of the subject company, and the nature of the financial interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position)
 - (b) any other actual, material conflict of interest of the trading member or research analyst of which the trading member knows or has reason to know at the time of publication of the research report.

7. Record Keeping

- a) Trading members shall establish and maintain procedures to ensure that sufficient information is recorded and retained about their business

and clients for enabling themselves to justify the risk profiling of their clients and the suitability of any advice given.

8. General obligations

- a) Fictitious accounts: Trading members shall not allow establishment of fictitious accounts in order to execute transactions which otherwise would be prohibited or to disguise such transactions.
- b) Unauthorized transactions: Trading members shall not cause to execute transactions which are not explicitly authorized by the client concerned.
- c) Misuse of customers' funds or securities: Trading members shall not use clients' funds and / or securities otherwise than as prescribed in the rules, bye-laws, regulations and circulars issued there under.
- d) Front running: Trading members shall not execute transactions for own account in securities ahead of making recommendations to their clients in such securities. Trading members shall also have adequate systems in place to maintain the confidentiality of the information about their dealing by their clients.
- e) Trading members or their representatives shall not indulge in any fraudulent activities, such as forgery, non-disclosure or misstatement of material facts, manipulations and various deceptions. Making, directly or indirectly, any false or misleading advertisement or any untrue statement of a material fact, constitutes a fraudulent, deceptive or manipulative act on the part of trading members.

Comments/suggestions are invited on the above proposals. Comments/suggestions may be sent to the address mentioned below to Mr. Susanta Kumar Das, Assistant General Manager, Integrated Surveillance Department, SEBI before April 15, 2008.

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Comments/suggestions may also be emailed to susantad@sebi.gov.in or to sunilk@sebi.gov.in before April 15, 2008.
