CIR/DNPD/5/2011

June 2, 2011

To

Managing Director/ Chief Executive Officer
Recognized Stock Exchanges

Dear Sir/Madam,

Sub: Liquidity Enhancement Schemes for Illiquid Securities in Equity Derivatives Segment

1. In consultation with BSE, MCX-SX, NSE and USE, it has been decided to permit Stock Exchanges to introduce one or more liquidity enhancement schemes (LES) to enhance liquidity of illiquid securities in their equity derivatives segments.

2. The Stock Exchange shall ensure that the LES, including any modification therein or its discontinuation,
   a. has the prior approval of its Board and its implementation and outcome is monitored by the Board at quarterly intervals;
   b. prescribes and monitors the obligations of liquidity enhancers (liquidity provider, market maker, maker-taker or by whatever name called);
   c. disburses the incentives linked to performance;
   d. is objective, transparent, non-discretionary and non-discriminatory;
   e. does not compromise market integrity or risk management;
   f. complies with all the relevant laws; and
   g. is disclosed to market at least 15 days in advance and its outcome (incentives granted and volume achieved – liquidity enhancer wise and security wise) is disseminated monthly within a week of the close of the month.

3. The LES can be introduced in any of the following securities:
   a. New securities permitted on the Stock Exchange after the date of this circular,
   b. Securities in case of a new Stock Exchange / new Segment, and
   c. Securities where the average trading volume for the last 60 trading days on the Stock Exchange is less than 0.1% of market capitalization of the underlying.
4. The LES can be discontinued at any time with an advance notice of 15 days. It shall, however, be discontinued as soon as the average trading volume on the Stock Exchange, during the last 60 trading days, reaches 1% of market capitalization of the underlying, or six months from introduction of the scheme, whichever is earlier.

5. If a Stock Exchange introduces LES on securities eligible under Para 3 above, other Stock Exchanges may introduce LES in the same / competing securities even if those are not eligible under Para 3 above. Such LES of the other Stock Exchanges cannot be continued beyond the period of LES of the former stock Exchange.

6. The incentives under LES shall be transparent and measurable. These may take either of the two forms:

   a. Discount in fees, adjustment in fees in other segments, cash payment;

   b. Shares, including options and warrants, of the Stock Exchange.

7. If a Stock Exchange chooses the form specified in Para ‘6a’ above, the incentives under all LES, during a financial year, shall not exceed 25% of the net profits or 25% of the free reserves of the Stock Exchange, whichever is higher, as per the audited financial statements of the preceding financial year. If, however, a Stock Exchange chooses the form specified in Para ‘6b’ above, the shares, including the shares that may accrue on exercise of warrants or options, given as incentives under all LES, 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.

8. The Stock Exchange shall submit half-yearly reports on the working of its LES for review of SEBI.

9. The implementation of this circular shall be covered in the inspection of the Stock Exchange.

10. This circular is issued in exercise of the powers conferred under Section 11(1) of the Securities and Exchange Board of India Act 1992, read with Section 10 of the Securities Contracts (Regulation) Act, 1956 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

11. The circular shall come into force from the date of the circular.

12. This circular is available on SEBI website at www.sebi.gov.in under the category “Derivatives- Circulars”.

Yours faithfully,

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