CIRCULAR

CIR/MRD/DP/14/2014 April 23, 2014

To

All Stock Exchanges

Dear Sir / Madam,

Sub: Revised guidelines for Liquidity Enhancement Scheme in the Equity Cash and Equity Derivatives Segments

1. SEBI vide circular CIR/DNPD/5/2011 dated June 02, 2011 and circular CIR/MRD/DP/14/2010 dated February 08, 2013 permitted stock exchanges to introduce liquidity enhancement schemes in the equity derivatives and equity cash segments to enhance liquidity in illiquid securities.

2. Based on the experience of stock exchanges in offering liquidity enhancement schemes in the equity cash and equity derivatives segments, and based on the discussions held in Secondary Market Advisory Committee, it has been decided to revise the framework for providing liquidity enhancement schemes as given below.

3. Introduction of liquidity enhancement schemes - The stock exchange may introduce liquidity enhancement schemes in equity cash and equity derivatives segments subject to the following:

    3.1. The scheme shall have the prior approval of the Stock Exchange's Board and its implementation and outcome shall be monitored by the Board at quarterly intervals.

    3.2. The scheme shall be objective, transparent, non-discretionary and non-discriminatory.

    3.3. 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.

    3.4. The scheme shall not compromise market integrity or risk management.

    3.5. The effectiveness of the scheme shall be reviewed by the stock exchange every six months and the stock exchange shall submit half-yearly reports to SEBI.

3.6. The scheme, including any modification therein or its discontinuation, shall be disclosed to the market atleast 15 days in advance.

3.7. Outcome of the scheme (incentives granted and volume achieved – market maker wise and security wise) shall be disseminated monthly.

3.8. The scheme shall comply with all the relevant laws.

4. Securities eligible for liquidity enhancement schemes - The stock exchange shall formulate it's own benchmarks for selecting the securities for liquidity enhancement with the broad objective of enhancing liquidity in illiquid securities.

4.1. The stock exchanges shall introduce liquidity enhancement schemes on any security for a maximum period of three years. Once the scheme is discontinued, the scheme can be re-introduced on the same security provided it is less than the three year period since the introduction of scheme on that security.

4.2. Further, a stock exchange may introduce liquidity enhancement schemes in securities where liquidity enhancement scheme has been introduced in another stock exchange. Such schemes cannot be continued beyond the period of liquidity enhancement schemes of the initiating stock exchange.

4.3. The list of securities eligible for liquidity enhancement shall be disseminated to the market.

5. The incentives under liquidity enhancement schemes shall be transparent and measurable, and may take either of the following two forms:

5.1. 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 stock exchange, whichever is higher, as per the audited financial statements of the preceding financial year.

5.2. Shares, including options and warrants, of the stock 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 stock exchange shall ensure that this is in compliance with the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 at all times.

6. Market integrity - The stock exchange shall ensure the following:

6.1. The stock exchange shall have systems and defined procedures in place to monitor collusion between stock brokers indulging in trades solely for seeking incentives and prevent payment of incentives in such cases.

6.2. 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.

6.3. Any violations of clauses in this para shall be viewed most seriously.

7. 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)

7.1. All market maker / liquidity enhancer orders / trades should be identifiable by the stock exchange.

7.2. A conflict of interest framework shall be put in place by the stock 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 stock exchange on their website.

8. This circular shall not be applicable to securities listed on SME Platform or SME Exchange.

9. This circular shall supersede earlier SEBI circulars viz. CIR/DNPD/5/2011 dated June 02, 2011 and CIR/MRD/DP/14/2010 dated February 08, 2013 on liquidity enhancement in the equity derivatives and equity cash segments.

10. Stock Exchanges are directed to:

10.1. take necessary steps to put in place systems for implementation of the circular, including necessary amendments to the relevant byelaws, rules and regulations;

10.2. bring the provisions of this circular to the notice of the stock brokers and also disseminate the same on its website;

10.3. communicate to SEBI the status of implementation of the provisions of this circular.

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

Yours faithfully,

Maninder Cheema
Deputy General Manager
email: maninderc@sebi.gov.in